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TO EXTEND THE CREDIT CONTROL ACT

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 6124

A BILL TO REDUCE INTEREST RATES, CONTROL INFLATION, AND ENSURE THE AVAILABILITY OF CREDIT FOR PRODUCTIVE PURPOSES, AND PROMOTE ECONOMIC RECOVERY BY EXTENDING THE CREDIT CONTROL ACT

JULY 14, 15, AND 16, 1982

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I

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TO EXTEND THE CREDIT CONTROL ACT

WEDNESDAY, JULY 14, 1982

House of Representatives,
Subcommittee on Consumer Affairs and Coinage,
Committee on Banking, Finance and Urban Affairs,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in room 2128, Rayburn House Office Building; Hon. Frank Annunzio (chairman of the subcommittee) presiding.

Present: Representatives Annunzio, St Germain, Gonzalez, Patman, Hoyer, Paul, Evans, Wylie, and Carman.

Chairman Annunzio. The meeting of the subcommittee will come to order.

Interest rates, it has been said, are like the weather—everyone talks about them, but no one does anything about them.

Today, this subcommittee meets to do something about interest rates as it begins hearings on H.R. 6124, a bill that would reinstate the authority of the President to invoke the Credit Control Act.

In addition, the bill would permit the President to use the credit control powers to help reduce high unemployment and to control or prevent recession. The bill would also allow credit control to be used to slow or prohibit the use of credit for nonproductive purposes such as unnecessary corporate takeovers.

The members of this subcommittee are indeed fortunate that they will have an opportunity during an election year to vote for or against high interest rates. It will give Members an interest rate record to take to the voters in November.

The devastating effects of high interest rates are all around us. Last year, over 66,000 businesses filed for bankruptcy. In the first 5 months of 1982, business bankruptcies are running 15 percent ahead of last year, and 32,000 have already been filed. Every 7 minutes another business goes bankrupt. Consumer bankruptcies are at record levels, with 460,000 filed in 1981 and an equal number likely this year. Timewise, there is a consumer bankruptcy every 69 seconds.

Unemployment is at record levels. Nationally the rate is 9.5 percent, or 1 worker in 11. Among construction workers the rate is over 18 percent. In the automobile industry the rate is 25 percent. And these rates do not count the millions of Americans who have simply given up looking for work, since they are not counted as officially employed.

American consumers have felt the effects of high-interest rates as well. Ninety-five percent of all American families have been priced out of homeownership. A $50,000 mortgage at today's 17-percent rate will cost over a quarter of a million dollars in payments over 30 years. At today's high rates, homeownership is no longer the American dream: it is the impossible dream.

The effect of high interest rates on the automobile industry has been devastating. Over a quarter of a million automobile workers are on permanent layoff at the big four auto producers alone. Volkswagen's Westmoreland plant announced last week that workers would go on leave for 6 weeks rather than the customary 2. In May, General Motors offered 12.4-percent financing, and sales increased. The offer expired in June, and sales dropped to record lows. How much more proof do we need that interest rates have put the automobile industry on blocks?

Although credit is not available to the small businessman, to the automobile purchaser, to the homebuilder or the home buyer, it is available to one group: Giant corporations engaged in merger activity.

In 1981, over $70 billion in lines of credit were made available to corporations engaged in takeover fights. The chart on the easel shows the largest of these loan commitments. The five largest accounted for $25.5 billion in lines of credit, over one-third of all the credit available for mergers in 1981. The average American could not borrow $6,000 to shop for a new car last year, but Mobil could borrow $6 billion to shop for Marathon and Conoco.

These billions did not build any new plants or cars or houses. They created no jobs. The money was used solely to change corporate ownerships. There is nothing productive in this kind of activity.

But what would happen if instead of using the $70 billion to satisfy corporate egos, that money was used for solving unemployment? This $70 billion would buy 11,666,667 automobiles priced at $6,000 each, or 1,166,667 homes at $60,000 apiece.

But did we build cars and houses? No, we developed new corporate logos. This type of mergermania has two negative effects as well. First, makes less credit available for other purposes. A bank that has committed billions of dollars to a single customer has that many dollars less available for other borrowers.

And, second, the money that is left for other purposes is more expensive since there is less of it, and that is one of the main reasons why we have seen increases in the prime rate.

How much longer can we afford to permit these games of corporate musical chairs to pummel our economy with a one-two punch of less credit and higher interest rates?

The Federal Reserve continues with its policy of tightly restricted monetary growth, with seeming indifference to interest rates. The target of this policy is supposed to be inflation. The Fed's aim, however, is like a near-sighted policeman firing a shotgun into a crowd.

Inflation, the Fed's mortal enemy, is virtually unscratched, running at a 12-percent annual rate according to last month's figures. But the auto industry lies bleeding, the housing industry lies bleeding, farmers are bleeding, small businesses are bleeding, consumers, workers, and home buyers all are bleeding from the Fed's poorly aimed blasts. How much longer can we permit the slaughter to go on?

The administration has indicated it does not want this legislation. I would point out that the authority granted to the President is permissive, not mandatory.

The administration's opposition is like a driver starting on a cross-country trip who refuses to take along a spare tire. The driver reasons that in the past he has not had a flat tire, so, therefore, no spare is needed. That logic holds up only as long as there are no flats.

Credit controls are the spare tire of our economy, and we can no longer afford to travel the economic highway without a spare. We started the journey with supply-side economics, but the only thing that has been supplied to the American people has been high interest rates, unemployment, bankruptcy and economic chaos.

All of these have been brought about with the budget of the administration, the tax program of the administration, the monetary policy of the administration, and the economic game plan of the administration.

We are being supplied right into the poorhouse. And before it is too late, it is time to put the spare tire in the trunk.

[A chart entitled "1981 Loan Commitments for Mergers" follows:]

1981 LOAN COMMITMENTS FOR MERGERS

LEAD BANK	COMPANY	LINE OF CREDIT ($ billion)
Citibank	Mobil	6
Chase Manhattan	Texaco	5.5
Bankers Trust	Gulf	5
Chase Manhattan	Marathon	5
Morgan Guaranty	Cities Service	4
Citibank Manufacturers Hanover Bank of Montreal	Seagrams	3.2
unknown	Shell	3
Bank of America	Conoco	3
Citibank	Pennzoil	2.5
Chase Manhattan	Allied Corporation	2
Morgan Guaranty	Sohio	2
Citibank	Dome Petroleum	1.8
Morgan Guaranty	Fluor	1
SUBTOTAL		48.0
other smaller commitments		25.5
TOTAL		73.5

Chairman ANNUNZIO. Now, I recognize the ranking minority member, Mr. Ron Paul.

Mr. PAUL. Thank you, Mr. Chairman.

The Credit Control Act died a deserved death two weeks ago. We may be wise in reviewing the Credit Control Act and its economic and legal implications at this time, but we would be foolish to revive the act. I agree that we have interest rates today that are worsening the effects of the recession. The high home mortgage rates have deterred conventional financing, encouraged risky seller financing, and discouraged the demand for housing. High interest rates have dampened business investment and restricted consumer purchases. I need not cite further examples, for we all are well aware of the effects of high interest.

What we fail to recognize, though, is that high interest rates are only a symptom of a sick paper currency, and nothing else. Until we come to recognize this, we will not solve the problem of high interest rates.

Our hearing today and for the next 2 days will dwell almost exclusively on effects, perceived and real, of high interest. With the Credit Control Act as our subject, we can do no more than discuss the symptoms. To do anything about high interest rates and the damage they wreak, we must know the causes of those high interest rates.

We will not emerge from these hearings with any additional knowledge about the causes of high interest rates if we focus our attention on the various possible methods of allocating credit among the several economically or politically attractive applicants for credit.

Time and again, we must relearn the few simple economic lessons that governmentally imposed controls teach us. Economic controls of any sort—wage and price controls, credit controls, interest rate controls, people controls—provide only symptomatic relief from any problem they seek to solve. They promote economic distortions by providing people with incentives to evade controls.

We see this with the financial institutions' creativity in trying to avoid regulation Q and in the recent success of the money funds.

We know, or can learn, of the multitude of devices people used in the early 1970's to avoid the effect of wage and price controls.

In the 1980's, we saw the rapid emergence of new forms of money funds as a response to the short-lived credit control program of that year.

When controls are removed, we face another set of problems, just as serious as the controls were intended to solve. When the wage and price controls of 1972-74 ended, they were followed by a period of inflation and market distortion.

With the diminishing influence of regulation Q, we see distress on the liability side of financial institutions ledgers that probably never would have existed without the artificially low interest mandated by regulation Q.

My point is simply that the Government is an inefficient controller of the economy. No matter how well-meaning or how careful we are, we cannot change the Government into an entity which can effectively control the economy. The hearings we begin today should show us that fact again.

In 1980, we succeeded in enacting a sunset date for the Credit Control Act. We were supported in this effort by a large number of groups with often diverging interests. Representatives of the American Association of Retired People and the Credit Union National Association joined with bankers and business groups to support the expiration of the Credit Control Act. They agreed that the cost of credit controls in terms of jobs, investment, and income outweighed any short-term benefits.

The Credit Control Act has never served a legitimate purpose. It was enacted during a prior period of economic distress primarily to be used as a political bludgeon against the administration.

The Carter administration was the only one which used its powers in a desperate attempt to reduce inflation and interest rates.

Now, we are faced again with the prospect of enacting a dangerous law only to serve some politically opportunistic purpose. I hope we resist this temptation.

Chairman ANNUNZIO. Thank you, Mr. Paul.

Now, we will hear from the distinguished chairman of the full committee, the author of the legislation, H.R. 6124. I am proud to say, I commend the chairman of the full committee for encouraging me to go ahead with the hearings, and for the outstanding job that he has done with the entire committee to bring to the attention of the American people field hearings that were held all over the United States.

He was the first Member of the Congress, as a chairman, to go out into the field throughout the country. We heard from the people in those areas. We heard the problems and the plight facing the American people because of the high interest that this Nation is charging to people who are desirous of making loans.

Mr. ST GERMAIN. I want to thank the distinguished chairman of the subcommittee for his kind remarks and for his participation and his assistance in the hearings we did hold all around the country on the economy.

It was beneficial for the Members who did attend and especially beneficial to the people around the country who, as they stated, in each and every instance, could not come to Washington, and asked us to bring the message to Washington, and that is what we will be doing in these hearings, among other things.

Unless interest rates drop soon, the U.S. economy will be a wasteland. For many sectors, particularly the credit-intensive construction industry, it is already scorched earth.

In the face of skyrocketing business bankruptcies and 10 million Americans without jobs, we have had little more than handwringing about high interest rates from the administration and the Federal Reserve.

Throw the high interest gods another social program and we will have lower interest rates, we are told month after month by the administration's assortment of economic experts. The administration's budget has devastated everything from housing to health, and we still have the cruelest interest rate structure in the history of this Nation.

The Federal Reserve's medieval remedies call for a little tighter grip on the jugular of a patient already gasping for breath.

Credit controls are not the total answer. But my bill, H.R. 6124, does give the administration and the Federal Reserve another tool to deal with the serious dislocations in the credit markets. Credit controls, as a standby power, also give the President and the Federal Reserve a first-class jawboning device even if they are not ultimately imposed.

Credit controls not only provide a means of moderating interest rates in essential sectors of the economy, but they also can be utilized to prevent the flow of unnecessary credit into nonproductive and speculative areas. At a time when small businessmen are begging for credit to stay in business, there is no reason that the Nation's limited supply of money should be siphoned off so that the executives of a billion-dollar oil corporation can play the merger and acquisition games with their friends at the club.

It is essential, in my opinion, that the Congress move swiftly to renew this authority. Failing to do so would be a signal to the entire economy that the Congress was turning its back on the No. 1 problem afflicting every worker, every business, and every household in America—high interest rates.

I spent the period, the district work period, in my district in Rhode Island each and every day. Wherever I went, whenever people came into the office, the same question was asked of me from people from every strata of the economic society of my district: When are interest rates going to come down? That is the No. 1 problem in their minds, and they are correct.

I am sure that we will hear the long litany of cliches against controls. It is true; controls are not perfect. For those who will remind us of the problems of controls, let me remind them that a devastated economy, with growing business failures, lengthening lines of unemployed also falls somewhat short of perfection. Yes, all of us can wish that economic conditions did not require talk of controls. But, we are charged with facing the realities of the economy, not the fantasy of some ideal world that exists only in movie scripts.

H.R. 6124 provides for standby powers. It will be up to the President and his advisers to decide when and where they are to be used and administered by the Federal Reserve. If the economy continues to slip toward the brink, the President may well have to take decisive and quick action, his prior protestations notwithstanding. It is important that he have powers in place.

Some of us were on this committee in 1970, when we launched the efforts to provide standby wage and price controls. President Nixon denounced the committee, swore he would never use the powers, and signed the act only because it was tied to other essential legislation. A little more than a year later, he found it necessary to use the powers and all of his "never, never" lines were forgotten.

So this administration may well give us some more of the same rhetoric, but I am convinced that they will feel much more comfortable with the powers in the corner, available for the President's use. I think we can trust the President with these powers.

H.R. 6124 says that the Congress wants action that will lead to lower interest rates and a more equitable distribution of available credit. I hope that we can act quickly and favorably. I want to commend the chairman of the subcommittee for the excellent manner in which he has put these hearings together and for his strong support of the legislation.

You listed the various high unemployment rates in various sectors of the economy. Last night's news had a segment on steelworkers, their upcoming contracts. They interviewed steelworkers who have been out of work for more than a year. Unemployment in the steel industry—35 percent unemployment in the steel industry.

I commend you for getting these hearings going and the manner in which you have put them together, because I think it imperative that we act in this area.

[The text of H.R. 6124 follows:]

I

97TH CONGRESS
2D SESSION

H. R. 6124

To reduce interest rates, control inflation, and ensure the availability of credit for productive purposes, and promote economic recovery by extending the Credit Control Act.

IN THE HOUSE OF REPRESENTATIVES

APRIL 20, 1982

Mr. ST GERMAIN introduced the following bill; which was referred to the Committee on Banking, Finance and Urban Affairs

---

A BILL

To reduce interest rates, control inflation, and ensure the availability of credit for productive purposes, and promote economic recovery by extending the Credit Control Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 211 of the Credit Control Act (12 U.S.C. 1910) is hereby repealed.

SEC. 2. (a) Section 205(a) of the Credit Control Act (12 U.S.C. 1904(a)) is amended to read as follows:

"(a) Whenever the President determines that such action is necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession, the President may authorize the Board to regulate and control any or all extensions of credit.".

(b) Section 206 of the Credit Control Act (12 U.S.C. 1905) is amended by redesignating paragraphs (7) through (11) as paragraphs (8) through (12), respectively, and by inserting after paragraph (6) the following:

"(7) prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes.".

Chairman **Annunzio**. Thank you, Mr. Chairman, for a very constructive and excellent statement.

Another distinguished member of our subcommittee is Mr. Carman of New York.

Would you like to make a statement?

Mr. **St Germain**. May I ask your indulgence? As of today, we have 50 cosponsors on the legislation.

Chairman **Annunzio**. Thank you very much. You are hard workers.

Mr. Carman?

Mr. **Carman**. Thank you very much, Mr. Chairman, for this opportunity to make a preliminary statement in regard to this legislation. I hold the chairman of the overall committee, Mr. St Germain, in great esteem. He is a very experienced legislator and has been here for many years, but I respectfully suggest to the committee and the subcommittee that this legislation is tantamount to putting a Band-Aid and a heavy dose of iodine on a boil.

The fact of the matter is that any caring person has to be extremely upset with the vast degree of unemployment and the high interest rates that are running across this land, I also think it is important to understand in some measure why, I repeat, why the high interest rates and the high unemployment have been visited upon our country and are causing such difficulties in the economic recovery program.

As a freshman Congressman, I came here, highly motivated and as a person who has extensive experience in the business sector. I am fully aware of how ineffective controls of all sorts have been, especially when imposed by government, simply because of Government's inability to be effective in their implementation.

The last round of credit controls certainly had numerous problems that exacerbated many of the difficulties they were designed to correct, but I would like to suggest right now, in this subcommittee, that we sit down and just say it like it is.

Why do we have these high interest rates? The reason we have these high interest rates are not because of what Mr. St Germain has said, or Chairman Annunzio has said, in regard to the need for a certain degree of discipline to be found in these areas. They are totally correct when they say these items of high unemployment and high interest rates need to be corrected. But what is more important, though, is to understand why. I would like to submit that in a bipartisan sense, it is absolutely essential that we understand that as long as this Congress continues to vote for tobacco subsidies, dairy subsidies, continues to vote for huge construction projects that simply are not accurate or do not have any need whatsoever, there would be a total and complete waste of money.

As long as we continue to have budget deficits and more especially spending programs that move us way in excess of $100 billion every year, we are going to continue to have high interest rates and an economy that is going to be very heavily pressed.

I specifically point out that, for example, in the Bureau of Indian Affairs, we have a budget in that area that is over $1 billion a year. It is acknowledged by everyone that it does not serve any purpose; it is duplication and services are incredible. We know it, and the public knows it. I suggest that one of the things that ought to be done is that that element, or more especially, that unlimited spending capability, be brought under control.

It is for this reason that the President of the United States has come on so strongly for a balanced budget concept, going to the degree of having a constitutional amendment to balance the budget, which may or may not ultimately find implementation, but certainly the Congress ought to start waking up. When we have a subcommittee meeting like this, and talk about credit controls, those controls that need to be imposed are those upon us here in Congress who feel incumbent upon ourselves to spend and spend to simply give someone some sort of political advantage and simply rape the people in the names of going out and saying, this is going to be another worthwhile dog and pony show.

It is a lot of baloney, and it has to stop. This business of putting Band-aids on boils does not work, and, from my point of view, it is about time that all of us recognize that we have to get certain essential legislation underway in order to make some sort of adjustments and make credit available for the construction industry that so desperately needs it. I commend your attention to the St Germain bill now before this committee, specifically dealing with the net worth problems of savings and loans associations and what is going on over in the Senate.

I am hopeful we will get some sort of implementation of that certainly before this next recess comes up, and before November.

As these hearings unfold, we will hear a tremendous amount of testimony on both sides. All of us would like to see unemployment brought to an end, or brought into a reasonable scope of acceptability so that people can have jobs and get on with the business of the Nation.

We want to see these interest rates lowered, and they can be lowered, but they are not going to be lowered as long as we embrace budget deficits for nonsensical programs that go on for over a $100-billion-plus every single year, and that goes for not only the domestic side, but for military expenditures as well.

We need someone to stand up and say it like it is on both sides. That is what the American public needs now. To come in with another program for controls, just seems to me to be one more lesson in futility which again will frustrate the problem and serve no useful purposes, and indeed, I believe, may very well contribute to further unemployment in this particular sector of the economy.

So, I, therefore, will look forward to these hearings with great interest. I will do my utmost to keep an open mind to what is going to be presented at these particular hearings, but I want you to know, and I feel very strongly about this, that I hope the other members of the committee will keep an open mind in regard to it, and I will listen with great interest to the testimony as it unfolds and hope we will be able to come up with a constructive result.

Chairman ANNUNZIO. Thank you, Mr. Carman.

Mr. ST GERMAIN. Will you yield?

Mr. CARMAN. I will be happy to yield.

Mr. ST GERMAIN. You ended up talking about an open mind, and I am confused. I guess the opening is about the size of a tiny needle.

Mr. CARMAN. Just think what can happen with the eye of a needle.

Mr. ST GERMAIN. Another thing, on the Bureau of Indian Affairs, had you been with us in Tucson when the Papago Indian witnesses testified, if you would have heard this 82-year-old lady who is living in a wickiup describe the conditions under which they are attempting to survive, you might have a little different attitude, as far as the Bureau of Indian Affairs are concerned.

Mr. CARMAN. I won't for a moment walk away any more than you would, or any other caring Member of this Congress would, from our commitment to the American Indian. Frankly, we have not met our commitment to the American Indian.

What I object to, and you do, too, is anyplace where we have duplication. It is not a question of spending the money; it is how it is spent, and I listened to you for many years, and I know where you come from on this kind of thing.

You care very much about the people of this country, as we all do. It is a question of how we do it.

You have been here a lot longer than I have, but we simply must turn it around so we spend the money in a sensible fashion, so we are able to make sure that those people, like the woman you just described, will be in a position to receive the help she is entitled to have.

Chairman ANNUNZIO. I want to caution the members of the subcommittee; we want to proceed with these hearings, and I am sure that every member of the subcommittee has a deep-rooted feeling to help all of the American people, and we would like to find that road.

The secret is to get on with the business of government that represents the people. This is what government is all about, so if there are no further preliminary statements, I would like to proceed.

Our first witness today is Hon. Jim Weaver, from the Fourth District of Oregon, and for many years the Fourth District has been the most productive timber-producing area of our Nation, but high interest rates have had a devastating effect on the timber industry.

As chairman of the Agricultural Subcommittee on Forests, Family Farms, and Energy, Congressman Weaver is most familiar with the devastation that high interest rates have brought to our Nation's forests and farms.

I would like to introduce to the panel one of the distinguished leaders of the democracy of Cook County, my own ward committeeman from the city of Chicago, Alderman Anthony Laurino. It is a pleasure to have you with us today.

Before the other witness proceeds, there is another gentleman who is here this morning, who will appear as a witness, who also is a resident of the 11th Congressional District. This is Eleventh Congressional District Day at the hearing on credit controls.

This gentleman is an old friend of mine for at least 40 years, is a Republican, former Republican county chairman of Cook County, a former Republican candidate for mayor of the city of Chicago. He served in the Congress of the United States with honor and distinction, representing the 11th District for many, many years, and today he is the Republican Committeeman in the 44th ward of the 11th District in the city of Chicago. That is the highest delivery ward of the Republican Party in the city of Chicago, and I want to welcome him and also call to the attention that you have been a Reagan delegate to the National Committee, and that you are one of President Reagan's outstanding supporters in Illinois.

So I welcome you to the subcommittee as a witness today. Will you stand? And I am delighted that the 11th Congressional District is so ably represented.

Mr. Weaver, you may proceed.

STATEMENT OF HON. JIM WEAVER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OREGON

Mr. WEAVER. Thank you, Mr. Chairman, and I wish to thank you for your great leadership as well as the chairman's great leadership in the Banking Committee and in the introduction of this legislation of H.R. 6124, to extend the Credit Control Act of 1969.

I support this measure. Its passage would provide the President with a tool which could be used to ensure that the most productive sectors of our economy receive an adequate share of available credit.

When credit controls were invoked in the spring of 1980, interest rates on Treasury bills fell from 14 to 16 percent in 2 months, and then the credit controls were removed and the interest rates went back up again.

Today, we are faced with a situation where high interest rates have devastated the credit-sensitive industries of the economy, but meanwhile multibillion-dollar corporations have no difficulty in tying up enormous lines of credit for wasteful mergers.

It is clear that high interest rates favor the few that can afford to borrow under them—mainly big business—while the job-producing, small business sectors of the economy are shut down.

Something must be done to put credit-sensitive but productive industries on more level ground with the corporate giants. The extension of the Credit Control Act is a constructive first step.

Mr. Chairman, I am especially concerned with the credit problems of housing and the impact this has had on construction and forest products industries. This is the greatest housing depression in 35 years. New home production in 1981 was at roughly half the normal rate; unemployment in the construction industry nationwide is currently 18.8 percent.

Since interest rates are expected to remain high, little improvement is forecast for this year.

It is also appropriate to focus on the decline of the industries which support housing. In my capacity both as chairman of the Forest, Family Farms, and Energy Subcommittee, and as the Congressman from Oregon's Fourth District, which was formerly the greatest timber-producing district in the country, I am extremely concerned about the state of our Nation's forest products industry. The plain fact is that the housing crunch has destroyed the forest products industry—lumber and plywood production are way down and unemployment is skyrocketing.

There is 18 percent unemployment, in my district, actually 30 percent unemployment in some towns. Bankruptcies mount every day. My district is literally in a State that has little chance for recovery, unless we act soon.

For the week ending June 26, 200 Western sawmills were closed, and 154 were working reduced production schedules. In the previous week 172 mills were closed. Most of these work only to keep a cash flow going so they can stave off bankruptcy.

This means that 47 percent of Western sawmill capacity is now closed or curtailed. These reductions have led to layoffs or reduced hours for 48,100 employees. In the South, the situation is much the same. For the week ending June 26, 174 mills were closed, and 127 were working curtailed schedules, affecting 24,700 employees—46 percent of Southern capacity.

My God, these figures are devastating for us, and I really believe, Mr. Chairman, if you took all the policies of this Government and reversed them 180 degrees, we would be on the right track.

In my home State of Oregon, 24,000 fewer people were employed in the lumber and wood products industry in May 1982 than were employed in May 1978. In construction, 20,000 less persons were employed in May compared to May 1979. Two counties in my own district—Curry and Douglas—have unemployment rates of 17.5 percent and 17.3 percent, respectively, while four other counties have unemployment rates over 12 percent. These rates are actually much higher because people have left the State.

Mr. Chairman, a stable long-term source of mortgage credit is vitally important if we are to revive the housing sector. This slump has gone on far too long. The extension of the Credit Control Act is a first step toward ensuring that productive business, especially housing, cannot be crushed again.

Housing has been a national priority since the 1930's. All previous administrations have exhibited a bipartisan commitment to the 1949 Housing Act goal of "a decent home and safe living environment for every American family." Yet today the administration believes that all credit should be deregulated, that the housing delivery system that has worked successfully since the 1930's should be dismantled, and that America's young potential homebuyers should compete with big business for credit.

Think of that: One individual person, that is the buyer for the home, and he or she must compete with the giant corporations for credit.

Appropriate use of credit controls could help insure that there is a housing delivery system still intact when we get out of this economic and political morass.

The forest products industry, its employees and the economies of States such as Oregon have become just as dependent on housing as a national priority, as have potential homebuyers. In turning away from housing, the Reagan administration has turned its back on one of the most productive sectors of the economy, some of America's most productive regions and a generation of young Americans.

Let's make housing a national priority again. Let's build a system to allocate credit to other housing and job-producing sectors.

Giving the President the standby authority to invoke the Credit Control Act would send a signal to the White House and to Wall

Street that Congress is serious about how credit is used in our economy.

We will no longer abide by policies which exhaust our available capital on non-job-producing corporate mergers. The President needs the authority of the Credit Control Act to implement effective credit policies. The opposition of this administration should not deter the Congress from preserving this authority for future, more responsible administrations.

Mr. Chairman, thank you for the opportunity to present my views. I would appreciate your including these in your hearing record.

Thank you, Mr. Chairman.

[Mr. Weaver's prepared statement follows:]

STATEMENT OF REPRESENTATIVE JIM WEAVER BEFORE THE CONSUMER AFFAIRS AND COINAGE SUBCOMMITTEE OF THE HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE, JULY 14, 1982, ROOM 2129 RAYBURN, 10:00 A.M.

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY ON CHAIRMAN ST GERMAIN'S BILL, H.R. 6124, TO EXTEND THE CREDIT CONTROL ACT OF 1969. I SUPPORT THIS MEASURE. ITS PASSAGE WOULD PROVIDE THE PRESIDENT WITH A TOOL WHICH COULD BE USED TO ENSURE THAT THE MOST PRODUCTIVE SECTORS OF OUR ECONOMY RECEIVE AN ADEQUATE SHARE OF AVAILABLE CREDIT.

TODAY WE ARE FACED WITH A SITUATION WHERE HIGH INTEREST RATES HAVE DEVASTATED THE CREDIT SENSITIVE INDUSTRIES OF THE ECONOMY, BUT MEANWHILE MULTI-BILLION DOLLAR CORPORATIONS HAVE NO DIFFICULTY IN TYING UP ENORMOUS LINES OF CREDIT FOR WASTEFUL MERGERS. IT IS CLEAR THAT HIGH INTEREST RATES FAVOR THE FEW THAT CAN AFFORD TO BORROW UNDER THEM--MAINLY BIG BUSINESS--WHILE THE JOB PRODUCING, SMALL BUSINESS SECTORS OF THE ECONOMY ARE SHUTDOWN. SOMETHING MUST BE DONE TO PUT CREDIT SENSITIVE BUT PRODUCTIVE INDUSTRIES ON MORE LEVEL GROUND WITH THE CORPORATE GIANTS. THE EXTENSION OF THE CREDIT CONTROL ACT IS A CONSTRUCTIVE FIRST STEP.

MR. CHAIRMAN, I AM ESPECIALLY CONCERNED WITH THE CREDIT PROBLEMS OF HOUSING AND THE IMPACT THIS HAS HAD ON CONSTRUCTION AND FOREST PRODUCTS INDUSTRIES. THIS IS THE GREATEST HOUSING DEPRESSION IN THIRTY-FIVE YEARS. NEW HOME PRODUCTION IN 1981 WAS AT ROUGHLY HALF THE NORMAL RATE. UNEMPLOYMENT IN THE CONSTRUCTION INDUSTRY NATION-WIDE IS CURRENTLY 18.8%.

SINCE INTEREST RATES ARE EXPECTED TO REMAIN HIGH, LITTLE IMPROVEMENT IS FORECAST FOR THIS YEAR.

IT IS ALSO APPROPRIATE TO FOCUS ON THE DECLINE OF THE INDUSTRIES WHICH SUPPORT HOUSING. IN MY CAPACITY BOTH AS CHAIRMAN OF THE FORESTS, FAMILY FARMS AND ENERGY SUBCOMMITTEE AND AS THE CONGRESSMAN FROM OREGON'S FOURTH DISTRICT, WHICH WAS FORMERLY THE GREATEST TIMBER PRODUCING DISTRICT IN THE COUNTRY, I AM EXTREMELY CONCERNED ABOUT THE STATE OF OUR NATION'S FOREST PRODUCTS INDUSTRY. THE PLAIN FACT IS THAT THE HOUSING CRUNCH HAS DESTROYED THE FOREST PRODUCTS INDUSTRY--LUMBER AND PLYWOOD PRODUCTION ARE WAY DOWN AND UNEMPLOYMENT IS SKYROCKETING.

FOR THE WEEK ENDING JUNE 26, 200 WESTERN SAWMILLS WERE CLOSED AND 154 WERE WORKING REDUCED PRODUCTION SCHEDULES. IN THE PREVIOUS WEEK 172 MILLS WERE CLOSED. THIS MEANS THAT 47% OF WESTERN SAW MILL CAPACITY IS NOW CLOSED OR CURTAILED. THESE REDUCTIONS HAVE LED TO LAY OFF'S OR REDUCED HOURS FOR 48,100 EMPLOYEES. IN THE SOUTH THE SITUATION IS MUCH THE SAME. FOR THE WEEK ENDING JUNE 26, 174 MILLS WERE CLOSED AND 127 WERE WORKING CURTAILED SCHEDULES, AFFECTING 24,700 EMPLOYEES: 46% OF SOUTHERN CAPACITY.

IN MY HOME STATE OF OREGON, 24,000 FEWER PEOPLE WERE EMPLOYED IN THE LUMBER AND WOOD PRODUCTS INDUSTRY IN MAY 1982 THAN WERE EMPLOYED IN MAY 1978. IN CONSTRUCTION, 20,000 LESS PERSONS WERE EMPLOYED IN MAY COMPARED TO MAY 1979. TWO COUNTIES IN MY OWN DISTRICT--CURRY AND DOUGLAS--HAVE UNEMPLOYMENT RATES OF 17.5% and 17.3% RESPECTIVELY, WHILE FOUR OTHER COUNTIES HAVE UNEMPLOYMENT RATES OVER 12%.

MR. CHAIRMAN, A STABLE, LONG-TERM SOURCE OF MORTGAGE CREDIT IS VITALLY IMPORTANT IF WE ARE TO REVIVE THE HOUSING SECTOR. THIS SLUMP HAS GONE ON FAR TOO LONG. THE EXTENSION OF THE CREDIT CONTROL

ACT IS A FIRST STEP TOWARD ENSURING THAT PRODUCTIVE BUSINESS, ESPECIALLY HOUSING, CANNOT BE CRUSHED AGAIN.

HOUSING HAS BEEN A NATIONAL PRIORITY SINCE THE 1930S. ALL PREVIOUS ADMINISTRATIONS HAVE EXHIBITED A BIPARTISAN COMMITMENT TO THE 1949 HOUSING ACT GOAL OF "A DECENT HOME AND SAFE LIVING ENVIRONMENT FOR EVERY AMERICAN FAMILY." YET TODAY THE ADMINISTRATION BELIEVES THAT ALL CREDIT SHOULD BE DEREGULATED, THAT THE HOUSING DELIVERY SYSTEM THAT HAS WORKED SUCCESSFULLY SINCE THE 1930S SHOULD BE DISMANTLED, AND THAT AMERICA'S YOUNG POTENTIAL HOMEBUYERS SHOULD COMPETE WITH BIG BUSINESS FOR CREDIT. APPROPRIATE USE OF CREDIT CONTROLS COULD HELP ENSURE THAT THERE IS A HOUSING DELIVERY SYSTEM STILL INTACT WHEN WE GET OUT OF THIS ECONOMIC AND POLITICAL MORASS. THE FOREST PRODUCTS INDUSTRY, ITS EMPLOYEES AND THE ECONOMIES OF STATES SUCH AS OREGON HAVE BECOME JUST AS DEPENDENT ON HOUSING AS A NATIONAL PRIORITY, AS HAVE POTENTIAL HOMEBUYERS. IN TURNING AWAY FROM HOUSING, THE REAGAN ADMINISTRATION HAS TURNED ITS BACK ON ONE OF THE MOST PRODUCTIVE SECTORS OF THE ECONOMY, SOME OF AMERICA'S MOST PRODUCTIVE REGIONS AND A GENERATION OF YOUNG AMERICANS.

LET'S MAKE HOUSING A NATIONAL PRIORITY AGAIN. LET'S BUILD A SYSTEM TO ALLOCATE CREDIT TO HOUSING AND OTHER JOB PRODUCING SECTORS. GIVING THE PRESIDENT THE STAND-BY AUTHORITY TO INVOKE THE CREDIT CONTROL ACT WOULD SEND A SIGNAL TO THE WHITE HOUSE AND TO WALL STREET THAT CONGRESS IS SERIOUS ABOUT HOW CREDIT IS USED IN OUR ECONOMY. WE WILL NO LONGER ABIDE BY POLICIES WHICH EXHAUST OUR AVAILABLE CAPITAL ON NON-JOB PRODUCING CORPORATE MERGERS. THE PRESIDENT NEEDS THE AUTHORITY OF THE CREDIT CONTROL ACT TO IMPLEMENT EFFECTIVE CREDIT POLICIES. THE OPPOSITION OF THIS ADMINISTRATION SHOULD NOT DETER THE CONGRESS FROM PRESERVING THIS AUTHORITY FOR FUTURE, MORE RESPONSIBLE ADMINISTRATIONS.

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO PRESENT MY VIEWS. I WOULD APPRECIATE YOUR INCLUDING THIS IN YOUR HEARING RECORD.

Chairman **Annunzio**. I thank you for your testimony. I have no questions.

Mr. Paul?

Mr. **Paul**. I would like to insert a letter I referred to in my opening statement.

Chairman **Annunzio**. Without objection, the letter will be made a part of the record.

[The letter referred to by Mr. Paul follows:]

Credit Union National Association, Inc.
1730 RHODE ISLAND AVE., N.W. • WASHINGTON, D.C. 20036 • 202-828-4500

September 19, 1980

The Honorable J. William Stanton
3526 House Office Building, Annex 2
U.S. House of Representatives
Washington, D.C. 20005

Dear Mr. Stanton:

The Credit Union National Association, Inc., (CUNA) supports the Credit Control Sunset Act of 1980, H.R. 8085, and urges the House to accept its provisions. We believe that a review of the Credit Control Act of 1969 (P.L. 91-151) and the powers granted under it to the President and Federal Reserve Board is in the public interest.

As consumer lenders, the 22,000 federally and state-chartered credit unions in this nation have an important stake in both the strength of the economy and consumer credit issues affecting credit unions and their 40 million members. Credit unions do not favor an unhealthy proliferation of credit in our economy and extraordinary means may be necessary at times in certain "speculative" or "non-productive" areas. However, the very broad powers granted to the Federal Reserve Board under P.L. 91-151 are threatening and have, in fact, caused inequities for credit unions and their members during the 1980 implementation of that Act. H.R. 8085 provides the means whereby Congress can reassess the degree and scope of federal intervention in the credit-granting area.

CUNA's positions of record in opposition to credit controls and credit allocation were established and reaffirmed in 1958, 1966 and 1975. Those positions are attached.

It is important to note that the arguments for broad credit controls might have been more persuasive a dozen years ago when the Federal Reserve system had less coverage of the money supply through reserves of member banks. Thus any changes by the Federal Reserve Board in reserve ratios would impact disproportionately on member banks leaving large numbers of financial institutions and credit grantors relatively untouched. Credit controls seem more reasonable in that type of environment.

However, with the passage of Title I of P.L. 96-221, the Federal Reserve system has expanded its coverage of the money supply beyond member banks to include all depository institutions offering "transaction accounts" and "non-personal time deposits." In addition, the FRB has been granted authority in the same Act to require "supplemental reserves" of those institutions up to 4% above required monetary policy reserves. With this greatly broadened authority the Fed can now adjust reserve ratios with the knowledge that a broad segment of the financial community will be covered. Accordingly, there seems even less practical justification for credit controls now.

It is the role of credit unions to balance the saving and borrowing activities of their members, and this sets credit unions apart from other financial institutions as a self-regulator of credit granted. Because of monetary policy reserves, liquidity reserves and retained earnings, aggregate credit has to be allocated within a credit union but not in government specified areas. It is our opinion that the control of aggregate credit through the money supply is properly under federal jurisdiction, but that selective federal credit controls should be avoided.

The Credit Control Sunset Act of 1980 provides the proper approach to review this important consumer credit issue.

Sincerely,

Jim R. Williams
President

CUNA POSITION OF RECORD

In 1966, when Congress was getting involved in the role of allocating where credit would be most available, the CUNA Executive Committee reconsidered its 1958 position on stand-by credit controls. They reaffirmed CUNA's opposition to consumer credit controls.

Policy

In the event the subject of consumer credit controls should be raised again within the federal government, the position of the Credit Union National Association would remain unchanged from that of its 1958 statement, namely that CUNA is opposed to such controls.

Origin and Status

In 1966, the matter of granting standby authority to impose consumer credit controls was considered by the 89th Congress. The Washington office requested policy guidance as to CUNA's present decision on such controls. At that time the Governmental Affairs Committee reviewed a statement adopted by the CUNA Executive Committee in August 1958 placing CUNA unequivocally on record as opposed to consumer credit controls on the grounds that they are not effective, not necessary, unfair, dangerous, and impractical.

The CUNA Executive Committee approved the recommendation of the Governmental Affairs Committee, namely, to reaffirm CUNA's opposition to consumer credit controls.

In 1975, the Executive Committee dealt with the parallel issue of credit allocation by stating their disapproval of government moves in this direction.

Position

Whereas, the Credit Union National Association fully recognizes the serious social implications of an economy caught in the grip of inflation and recession; and

Whereas, we recognize also the need to provide adequate credit for social priority purposes including full employment and adequate housing at a reasonable cost; and

Whereas, Congress has under consideration various legislative proposals mandating the allocation of credit as a means of directing credit to specified social priorities;

Now Therefore, be it resolved: The Credit Union National Association recommends that Congress not proceed to enact laws directing the allocation of credit, but that it exercise its oversight authority to oversee more closely the monetary policies of the Federal Reserve and thereby influence on a more consistent basis the direction and implementation of monetary policy.

Origin and Status

Approved by Executive Committee, February 1975.

Mr. **Paul**. Also, should we submit any written questions, I ask that they also be made part of the record.

Chairman **Annunzio**. Without objection, questions will be submitted to the witness in writing, and you will be asked to answer those questions for the record.

Mr. **Weaver**. I would be delighted.

[The questions of Mr. Paul appear at the conclusion of the proceedings of this day.]

Mr. **Paul**. I do have one comment and one question.

Chairman **Annunzio**. Mr. Paul has one question.

Mr. **Paul**. I can't help, Jim, but be sympathetic with some of the things you say. I don't come up with the same solution on the Credit Control Act, but I agree that there is a bit of hypocrisy that goes on around here. There is already a lot of credit allocation in the market—$800 billion now in the Federal guaranteed loan programs, and a lot of the big companies are getting benefits from them. So I see your great sympathy for the little guy, and my solution is getting rid of all of the special privileges for big business rather than expanding the role of Government to guarantee it to the little guy.

Mr. **Weaver**. I support you on that.

Mr. **Paul**. One question, in particular, regarding the housing: Have you looked at what is happening in Houston right now? Right now, this year, in Houston, we have the greatest number of new housing starts in our whole history. Has it ever occurred to anybody to ask why?

Mr. **Weaver**. Yes, I know why. Because the oil industry money has funneled everybody else's money down to Houston and the Government is pouring more billions into military spending.

Mr. **Paul**. OK. That is an opinion which I think is incorrect, really, because the only thing that is in a recession in Texas right now is oil. That is what precipitated the bank failure in Oklahoma.

Mr. **Weaver**. You call $34 a barrel a recession, when lumber is selling $100 per thousand board feet less than it costs to produce?

Mr. **Paul**. The fact that we live in a State that has no income tax nor corporate taxes, labor laws that permit people to work at $6 to $8 an hour—which some people consider criminal—and other States try to compete and pay $18 to $20 an hour, and cause unemployment is very important. I see great danger in this, because you say there are too many houses in Texas; we should take the money out of Texas and allocate it to some State where labor is $18 an hour, too much welfare, and so forth. How can you justify this as being fair when the reason is that we have a better economy because we have better State laws?

Mr. **Weaver**. Respectfully, my dear friend, he knows that he is my dear friend, that we disagree on this thing, but I would like to say that the lumber you are buying to build those houses is starting to come from Canada, and I wish you would do something about it.

Mr. **Paul**. OK.

Chairman **Annunzio**. Mr. St Germain?

Mr. **St Germain**. Thank you.

Chairman **Annunzio**. I would like to proceed with the panels that have been good enough to be here this morning.

Mr. St Germain.

Mr. **St Germain**. I want to do two things: Initially, I want to thank our witness for his eloquent statement, his factual statement, and to say to him that having been to Seattle, where we had witnesses from Oregon, from the lumber industry, that we are fully aware, as of last fall, how devastating this situation is, and the hurt and suffering that is being inflicted on your people, so, really, you have made a fantastic presentation and been an eloquent spokesman for the people of your jurisdiction and your State and your area that are being subjected to so much suffering and on the Disney World that is known as Texas, I state that a recent article pointed out that there are a great deal of condos that have been built in Texas that are going unsold—unsold—and many of the developers have gone belly-up, that is, bankrupt, and they have had to sell, and there have been foreclosures.

So it is not the Utopia that it used to be.

Also, in our hearings, remember, Mr. Annunzio, many people said, well, we can go to Texas, but the Texas labor people rang a bell and said don't come to Texas. I don't think Texas is all that great.

I admire Texans and the State, but they, too, are suffering. Their housing market is suffering. Their builders are suffering. The immediate past president of the National Association of Home Builders was a Texan. You talk to him, and he does not see anything bright about housing in Texas.

I thank the Chairman.

Chairman **Annunzio**. Once again, I thank my distinguished colleague from Oregon for his very informative statement.

This morning, I want to welcome the first panel to the subcommittee, the Honorable Timothy P. Sheehan, who is president of Peerless Federal Savings & Loan Association of Chicago, representing the U.S. League of Savings Associations.

Welcome to the subcommittee, Mr. Sheehan, and it is a genuine pleasure for me to have you with us this morning.

Mr. **Sheehan**. Thank you, Mr. Chairman.

Chairman **Annunzio**. The Honorable Doris Miner, State senator from South Dakota.

Will you please take your place?

Mr. J. Morton Davis, president of D. H. Blair Co., of New York.

Mr. J. C. Turner, general president of the International Union of Operating Engineers, and I welcome you, Mr. Turner, to the subcommittee this morning.

In fact, I welcome all of the panelists before the subcommittee, discussing and getting your opinions on this legislation that has expired on June 30 of this year.

Each panelist has submitted a statement, and, without objection, your entire statement will be made a part of the record.

I am going to ask all of you to proceed in your own manner for at least 5 minutes, so that we can hear all of the panelists and have the members of the subcommittee ask questions.

The takeoff witness this morning is my dear friend from the 11th District, former Congressman Tim Sheehan.

STATEMENT OF TIMOTHY P. SHEEHAN, PRESIDENT, PEERLESS FEDERAL SAVINGS & LOAN ASSOCIATION OF CHICAGO, ILL., APPEARING ON BEHALF OF THE U.S. LEAGUE OF SAVINGS ASSOCIATIONS

Mr. SHEEHAN. Thank you, Mr. Chairman.

It is one of the greatest congressional districts in the State, and in the United States.

Chairman ANNUNZIO. I thank you for that statement.

Mr. SHEEHAN. The statement that I am about to make in behalf of the U.S. League of Savings Associations is a part of the record, so I will just try and skim through the high points in order to save the subcommittee as much time as I can.

I would guess offhand that everyone will agree that the military preparedness is a responsibility of our Government, even during peacetime. And I also believe that economic preparedness is a similarly appropriate concept, because if we suffer economically, all of the people, both rich and poor, will suffer along with it, and we have to always be thinking of our own people.

There are times when unexpected shocks can occur in our economic system, like wars occur all of a sudden. You have got to be prepared for them, and it is a question of doing what is necessary and putting powers on the books, even though they may not be exercised.

With fiscal and monetary planning shared among the administration, the Congress and the Federal Reserve, it is difficult to respond in a coordinated way, unless there is legislation already prepared and ready to act on. I know my Republican friends, and I speak as a Republican, know that many emergencies arise. It always takes time for legislation to get through, and with this particular legislation, as I understand it, it is up to the President to use it.

If he does not want to use it, he does not have to use it, but it is there to be used, just like the airplanes and the cannons are there ready to be used, even if you don't want to use them.

For these reasons and other reasons, the U.S. League feels that it is prudent to maintain on the statute books the authority of the Credit Control Act.

We realize that Public Law 91-151 has expired as of June 30, and, again, a lot of us who have been in Congress, a lot of us who are citizens, feel that there are too many laws on the books.

I don't particularly feel that way, because most of our problems, as I see it, both from my perspective as a former Congressman and as a citizen, are with the regulatory bodies. Sometimes if a good law is there, a regulatory body—whether it is the Federal Reserve or whoever it is—does not interpret it properly. Then you have problems. Maybe they should come back to the Congress and tell you what they are going to do, as the honorable chairman thinks should be done.

It would not take long, because the law is there, and they can exercise it.

We talk about the problems of the savings and loans, and the small banks. Yet we see here on the chart to the left that in 1981

$73.5 billion was allocated by big banks to companies speculating to buy out other firms.

It just so happens that that is about the amount of the shortfall that the savings and loan industry has had in making home loans during 1981 compared with a normal year for home mortgage credit.

Now, that does not necessarily mean that is where all the housing credit went, but certainly that chart illustrates some of the problem with credit flows that we have to be careful of.

We realize the market allocates credit. However, without guidance, the market sometimes allocates credit only to the strong, only to those who can successfully bid for it.

However, the market does not always reflect adequately national priorities, and many times in allocating it to the strong, what is meant is allocating it to whomever can pay the most—in spite of whom it might cause the most problems to.

For instance, certainly the people in giant corporate mergers are willing to pay any price, but the guy trying to buy a home in our district in Illinois, he can't get a mortgage, because he can't afford it, with the 16, 17, 18 percent rates we have today.

The big banks can provide credit at those rates to these big borrowers for corporate takeovers. Who is really paying for that? It is the small guy and his savings, but it is not going back to the small guy who is a borrower for a home or farm.

The municipalities, the small ones, are in trouble today, too, and they cannot compete with the big money markets and the giant banks in allocating credit.

Certainly, selective credit allocation would have some problems, unless it was properly done. I think that doing it properly is the purpose, Mr. Chairman, of your legislation here, and Mr. St Germain's legislation here—to make sure there must be an umpire around someplace to help this smaller guy.

We feel, too, that the Congress has been a great help, naturally, to the savings and loan business. The House has passed good legislation with your Net Worth Guarantee Act. It is now up to the Senate, and we are hoping that maybe if the proper things are done to let the savings and loans loan out more money, then the Congressman who preceded me, and his lumber worker constituents, will be protected, and everybody else will be protected in the sense that unemployment will diminish.

This is really what is meant by proper credit allocation, in my opinion.

Certainly, we are not objecting to corporate mergers. They are necessary, but sometimes we see the giants just buying up companies and letting men go and wanting more and more power and more and more market share. Something must be done eventually to protect the American public.

Funds are available for speculative ventures, when they are unavailable to the interest rate-sensitive activities. Again, speculation and risk-taking is an essential part of our economic life, and we do not condemn it as such, but we must question whether it deserves a priority for credit during periods of high interest rates and tight money.

In conclusion, Chairman Annunzio and members of the panel, we applaud your initiative in scheduling these hearings on legislation to reinstate the Credit Control Act.

Likewise, we appreciate Chairman St. Germain's leadership in introducing H.R. 6124.

While we do not deceive ourselves in the likelihood of its exercise by the Reagan administration, we hope that Congress will recognize the need for its availability as part of our Nation's economic preparedness.

Thank you very much for listening to us.

[Mr. Sheehan's prepared statement, on behalf of the U.S. League of Savings Associations, follows:]

STATEMENT OF TIMOTHY P. SHEEHAN
BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS & COINAGE
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
July 14, 1982

MR. CHAIRMAN:

My name is Timothy P. Sheehan. I am President of Peerless Federal Savings and Loan Association of Chicago, Illinois and appear today on behalf of the United States League of Savings Associations* -- where I am a member of the Legislative Committee.

Almost everyone would agree that "military preparedness" is a responsibility of our Government, even during peacetime. We believe that "economic preparedness" is, similarly, an appropriate concept.

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*The U.S. League of Savings Associations has a membership of 4,000 savings and loan associations representing over 99% of the assets of the $650 billion savings and loan business. League membership includes all types of associations -- Federal and state-chartered, stock and mutual. The principal officers are: Roy Green, Chairman, Jacksonville, FL; Leonard Shane, Vice Chairman, Huntington Beach, CA; Stuart Davis, Legislative Chairman, Beverly Hills, CA; William B. O'Connell, President, Chicago, Il; Arthur Edgeworth, Director, Washington Operations; Glen Troop, Legislative Director; and Phil Gasteyer, Associate Director, Washington Operations. League headquarters are at 111 East Wacker Dr., Chicago, Il 60601. The Washington Office is located at 1709 New York Ave., N.W., Washington, D. C. 20006. Telephone (202) 637-8900.

To maintain "economic preparedness", weapons such as the Credit Control Act belong in our national policy arsenal.

There are times when unexpected shocks can occur in our economic system: war in the Middle East or the Persian Gulf, actions by the OPEC cartel, climatic changes or crop failures. Exaggerated fears over budget deficits can rattle the credit markets. It is often impossible to anticipate such jolts to our complex economy, and to respond in a timely fashion when they occur. With fiscal and monetary planning shared among the Administration, the Congress and the Federal Reserve, it is difficult to respond in a coordinated way. And, there are periods in our national life -- such as the six months or so gap when elections occur and a new Administration assumes office -- when some of our governmental institutions are not fully "in place" to deal with economic problems.

For these reasons alone, the U.S. League believes it is prudent to maintain on the statute books the authority of the Credit Control Act.

Public Law 95-151 was last employed by President Carter in 1980. The imposition of credit controls had an immediate and salutory effect on the level of interest rates in the spring of 1980. This was welcome relief for the sector of the economy with which we are most concerned as home lenders. (The temporary imposition of reserves on money market mutual funds at that time was also helpful; it brought the largely unregulated money funds under the monetary policy mechanisms of the Federal Reserve -- an important function sadly lacking since the controls were removed.)

Indeed, in our judgment, the credit controls of 1980 might have been more successful in defusing inflationary pressures if they had not been relaxed and then abandoned in mid-year.

However, it is not our purpose today to defend the manner in which credit controls were exercised in 1980. Rather, we wish to argue for its reinstatement and continued availability as a national economic policy mechanism. The mere fact of its existence in the public laws will influence the conduct of regulatory officials in discharaging their responsibilities.

The market allocates credit. Without some guidance, however, the market allocates credit only to the strong -- those who can bid successfully for it. The market, however, does not always reflect adequately national priorities.

Small business and small municipalities, for example, are important parts of the American way of life. But they cannot obtain funds in periods of high interest rates and tight money without some form of credit allocation. They cannot attract essential funds on the basis of market competition.

The home finance and housing industries are in the same situation. Our savings and loan associations, for example, have found it extremely difficult to compete for funds for the last year and a half because of our legacy of low-yielding mortgage portfolios. (Unbalanced deregulation of savings has aggravated our problems, as well.)

Our inability to bid for funds has been reflected in a very low volume of home sales and housing starts. Diminished real estate activity, in turn, leads to unemployment in the construction trades and forest products industry, declining sales in the myriad of products which go into a home -- and, on a personal level, the tragic loss of skills and careers.

No one can be certain that selective credit allocation would have ameliorated the severe and uneven recession which now confronts the housing sector, small businesses, and municipal governments. But it is certainly conceivable that judicious use of the credit control powers could have kept interest rates in far more reasonable ranges and channeled more credit to those interest-sensitive activities.

With regard to depository institutions, judicious use of credit controls could conceivably have relieved the need for your full Committee and the House of Representatives to develop H.R. 6267, the Net Worth Guarantee Act, and H.R. 4603, the Depository Insurance Flexibility Act.

Left unguided, the market has been allocating credit in recent months to corporate mergers. It has been estimated that $82.6 billion was spent on corporate takeovers and mergers last year; $70 billion of this enormous sum came from commercial bank loan commitments. That credit is not available, of course, to housing, municipalities and small business which have borne the brunt of this recession.

We do not object _per se_ to corporate mergers. However, we must raise questions as to their priority in the national scheme of things. The markets cannot differentiate between the credit sought to finance corporate acquisitions and that needed by Main Street businesses.

Funds are available for speculative ventures when they are unavailable to the interest-rate sensitive activities. Again, speculation and risk-taking is an essential part of our economic life and we do not condemn it as such. But we must question whether it deserves a priority for credit during periods of high interest rates and tight money.

In reinstating Public Law 91-151, H.R. 6124 would enlarge the purposes under which the President might exercise the credit controls to include their use "to reduce high levels of unemployment in any sector of the economy", as well as the original instruction to prevent or control inflation. That additional purpose is an appropriate complement, in our view, to the goals set forth by the Humphrey-Hawkins Act enacted by the 95th Congress.

In conclusion Mr. Chairman, we applaud your initiative in scheduling these hearings on legislation to reinstate the Credit Control Act. Likewise, we appreciate Chairman St Germain's leadership in introducing H.R. 6124. While we do not deceive ourselves on the likelihood of its exercise by the Reagan Admininstration, we hope that the Congress will recognize the need for its availability as part of our nation's "economic preparedness".

Thank you for the opportunity to present the view of the U.S. League. I look forward to your questions.

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Chairman **Annunzio**. Thank you for your very excellent statement.

I would now like to ask for Doris Miner to summarize her statement.

I notice that your husband is a cattle rancher; that you work side by side, so you are familiar with the problems that beset the cattle industry and the farmers of America.

So I welcome you, senator, to the subcommittee this morning.

Your statement has been made part of the record, and you can proceed in your own manner.

STATEMENT OF HON. DORIS MINER, STATE SENATOR, STATE OF SOUTH DAKOTA

Mrs. **Miner**. Thank you, Mr. Chairman, members of the subcommittee. I have worked for almost 30 years beside my husband on a cattle and sheep ranch in western South Dakota, and I know from firsthand experience what the high interest rate is doing to the agricultural economy of our Nation.

I also currently am serving my third term in the South Dakota Legislature. In that position I travel all across the State and meet and talk with farmers and ranchers, and they tell me the difficulties that they face, and it is everyone, let me tell you that.

However, I am not here as a State senator to expound meaningless political rhetoric about what is wrong with the farm economy. I am not here to tell you how just my family has suffered in what can only be called a depression economy.

I am here to speak as a voice for the thousands of farmers and ranchers who are losing their livelihood, their homes, their very way of life. By telling you some of the individual stories of ranchers and farmers in my part of the State, I want you to see and feel the desperateness of the situation facing those of us in the agricultural sector who are being strangled by high interest rates and prices for our products that are fast approaching, and in some cases worse than, depression era levels.

One young man went broke. He was a good manager.

You can't slough it off, not when we feed the world.

The other young man had been in the service, came back, had farmed 4 years, and he did not have the backing that they could go with him another year; and that is a real sorrow when you see a family torn apart like that.

His wife was a little farm girl that he married, and she had the pride of wanting a nice-looking place, and this land that they bought had been a rented piece of property for 25 years, and she worked her heart out cleaning up that place—the sweat that she put into that, and it broke that woman.

My husband and I are among the more fortunate ranchers. We are supporting only ourselves and not a growing family. Our four children are grown and successful in the lives they have chosen—although our only son, who is a deputy sheriff in Blatte County, Wyo., would be home ranching with us if only we could afford the money needed to expand our ranching operation. We face the horrible specter of losing the land that has been in my husband's family since the Rosebud Sioux Indian Reservation opened for homesteading in the early 1900's.

Most ranchers, especially the young operators, have to face the reality of watching their land go on the auction block because they cannot meet payments, and I will tell you one of the saddest things that ever happens in a farming community is to go to a sale when one of your neighbors' farms is being sold out. Who has the money to buy it?

The collateral, the machinery, everything else is also depreciating. Tractors that would have sold for $40,000, these are used tractors, a $20,000 tractor, you are real lucky now at an auction block to get $10,000.

Mr. Shuman, Director of the FmHA, was on TV Monday evening, July 12, 1982, in our area, saying that "high interest rates are the farmers' No. 1 problem. Of all the costs that a farmer/rancher incurs to produce a crop, interest remains the largest. Interest rates for everyone are ranging from 16 to 21 percent." If you are one of the shaky customers, you are paying 21 percent.

Even our smalltown businesses do not go untouched. A family shoestore, a car dealership, and an implement dealer went out of business in our town of 1,500 in the past 6 months. We have no implement dealers left in our town.

The impact becomes more dramatic when one realizes how much of a single farmer's budget goes to interest payments. When coupled with low commodity prices, it is the interest payment that causes the farmer to go broke.

We are a small-to-average-size ranching operation—cow/calf. We raise the calves until weaning time on grass and sell to calf feeders in the Corn Belt. In 1979—and that was the best year that we had ever had—our income was $33,000, but our net was $6,594, and our interest payment that year in 1979 was $5,490, and our interest rate that year was 9.5.

OK, now I am going to give you 1980 income, $31,532, but our net—you have to realize what the expense of farming is—$1,420 was our net, and our interest payment was $6,743, and now you are starting to see the dramatic climb.

In 1981, our income dropped $10,000—$10,709 was what our income was. We had a net loss of $12,835, and our interest payment was $9,617. You can't afford it. You can't farm and ranch with that kind of interest. In 1979, calves per hundredweight were $100. In 1980, they dropped to $87 per hundredweight, and in 1981, $61 per hundredweight.

Now, a factor to ponder is that in 1982 the rate of inflation was about 2 percent, and interest rates ran about 4 percent.

You compare that with today's rates, and the grim reality is evident. South Dakota has the lowest income per capita in the Nation, and that is about $7,288.

Another thing on this interest is what the bankers are doing, and I guess they have to do it; they have to protect themselves, and because of this fluctuating market nobody has a long term. You don't go in for 6 months any more on your loan or a year. This is how they used to borrow money. Now, it is every 3 months, your interest, so it is a compounding factor. That is to be taken into consideration.

Here is a similar background of a small average grain farmer in our area, because this is what especially western South Dakota is, and I can speak better to that. Presently operating this fellow does 850 acres, and he started in 1949 and 1950 he was a veteran, came home and got married, and that is when he started putting his ranch together, and over the years he put together a 1,540-acre tract.

The average farming operation tract in South Dakota is 1,047 acres. You have to realize eastern South Dakota has a lot of small farms. Western has a lot of big acreage. Those people raised nine people, and, by 1975, he only owed against that land $12,000. But he felt that he had to get rid of this, and he sold part of his land.

In 1975, he sold 690 acres, which was approximately half of it, and that was all his pasture land, so he is strictly a grain farmer and today he is in debt $94,000, with a $20,000 disaster loan from Farmers Home. That was due to a drought in 1976, and his interest payment last year, right off his income tax, was $14,242, and his net was $410.

Now, our plight does not end at the edge of the farm. It continues to the closing of the small businesses in our towns to the urban centers where steel and rubber factories are affected. If a car dealer in South Dakota goes broke, that means fewer pickups, cars, trucks, and they have to be built.

There is an auto dealer laid off, and the economic power of another family is diminished, and he purchases less food for his family, and this story goes full-circle back to the breadbasket where the food is produced.

The greatness of America has always been the ability of the farmers of America to produce food for the entire world.

The concern and worry that I see on the faces of these farmers and ranchers across the State is evidence that the depression, this economic crisis, must end, and if we are to save our strength and greatness, I urge you to extend the Credit Control Act as amended, to give the President and the Federal Reserve Board the specific authority to combat this depression that has struck the agricultural economy so hard.

William Jennings Bryant said, and this is way back in 1896, and there is a beauty and a truth in it, "The great cities rest upon our broad and fertile prairies. Burn down your cities and leave our farms, and your cities will spring up again as if by magic; but destroy our farms and grass will grow in the streets of every city in the country."

Thank you.

[The prepared statement of South Dakota Senator Doris Miner follows:]

STATEMENT OF SENATOR DORIS MINER, SOUTH DAKOTA

I have worked for almost thirty years beside my husband on our cattle and sheep ranch in western South Dakota. I know from first-hand experience what high interest rates are doing to the agricultural economy of our nation.

I also currently am serving my third term in the South Dakota State Legislature. In that position, I meet farmers and ranchers from all over the state who tell me of the difficulties they face.

However, I am not here as a state senator to expound meaningless political rhetoric about what is wrong with the farm economy. I am not here to tell you how just my family has suffered in what can only be called a "depression" economy. I am here to speak as a voice for the thousands of farmers and ranchers who are losing their livelihood, their homes, their very way of life. By telling you some of the individual stories of ranchers and farmers in my part of the state, I want you to see and feel the desperateness of the situation facing those of us in the agricultural sector who are being strangled by high interest rates and prices for our products that are fast approaching, and in some cases worse than, depression era levels.

My husband and I are among the more fortunate ranchers. We are supporting only ourselves and not a growing family. Our four children are grown and successful in the lives they have chosen--although our only son, who is a deputy sheriff in Blatte County, Wyoming, would be home ranching with us if only we could afford the money needed to expand our ranching operation. We face the horrible specter of losing the land that has been in my husband's family since the Rosebud Sioux Indian Reservation opened for homesteading in the early 1900's. Most ranchers, especially the young operators, however, do face the reality of watching their land go on the auction block because they cannot meet payments on money borrowed against their land. To show you how high interest rates figure in:

Mr. Shuman, Director of the FmHA, was on TV Monday evening, July 12, 1982, in our area saying that "high interest rates are the farmers number one problem. Of all the costs that a farmer/rancher incurs to produce a crop, interest remains the largest. Interest rates for everyone are ranging from 16 to 21 percent. Even our small town businesses do not go untouched. A family shoe store, a car dealership, and an implement dealer went out of business in our town of 1,500 in the past six months. The impact becomes more dramatic when one realizes how much of a single farmer's budget goes to interest payments. When coupled with low commodity prices, it is the interest payment that causes the farmer to go broke.

We are a small to average size ranching operation (cow/calf). We raise the calves until weaning time and sell to calf feeders in the corn belt. In 1979, we had a gross income of $33,000 with our net of $6,594, our interest payment that year was $5,490 and the interest rate was 9.5%.

Year	Gross Income	Net Income	Interest Payment
1980	$31,532	$1,420	$6,745
1981	20,709	(12,835)	9,617

1979 Calves per hundred weight - $100.00
1980 Calves per hundred weight - 87.00
1981 Calves per hundred weight - 61.00

This is the similar background of small to average grain farmer in our area. Presently, operating 850 acres starting in 1949-50, when first married, he started putting together a ranch. Over the years, he put together a 1,540 acre tract, raised nine kids and in 1975 only owed $12,000 against the land. In 1975, he sold 690 acres, approximately half of his land (all his pasture), to pay off all he owed. Today he is in debt $94,000 with a $20,000 disaster loan from FmHA (due to 1976 drought). His interest payment last year was $14,242.89--his net was $410.

Our plight does not end at the edge of the last farm. It continues to closing of the small businesses in our towns, to the urban centers where steel and rubber factories are affected. If a car dealer in South Dakota closes, that means fewer pickups, cars, and trucks need to be built. More auto workers laid off. The economic power of another family is diminished. He purchases less food for his family. The story goes full circle back to the bread basket where food is produced.

The greatness of America has always been the ability of her farmers and ranchers to produce abundant and quality food for the entire world. The decline of this great force saps the strength of our nation. The concern and worry I see in the faces of my farmers/ranchers across the state is evidence that the depression, the economic crisis must end if we are to save our strength and greatness.

I urge you to extend the Credit Control Act as amended to give the President and the Federal Reserve Board the specific authority to combat this depression that has struck the agriculture economy so hard.

"The great cities rest upon our broad and fertile prairies. Burn down your cities and leave our farms. Your cities will spring up again as if by magic; but destroy our farms and grass will grow in the streets of every city in the country."

William Jennings Bryan

AVERAGE PRIME INTEREST RATE

Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual
1982	16.27	16.5			
1981	19.21	18.93	20.32	17.01	18.87
1980	16.40	16.32	11.61	16.73	15.27
1979	11.75	11.72	12.12	15.08	12.67
1978	7.98	8.30	9.14	10.81	9.06

Source: Business Conditions Digest, February 1982

South Dakota Gross Sales of Farm Machinery and Irrigation Equipment

Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual Total
1982	$28,080,694	$	$	$	$
% Increase	-27.1%				
1981	38,499,938	42,942,863	65,631,476	42,433,609	189,507,886
% Increase	-0.1%		9.5%	-17.3%	
1980	38,736,427	N/A	59,917,297	51,281,047	
% Increase	-15.9%		-12.8%	-28.6%	
1979	46,052,612	80,045,829	68,701,468	71,794,517	266,594,426
% Increase	50.1%	12.4%	10.3%	41.5%	24.1%
1978	30,672,869	71,189,395	62,271,825	50,733,310	214,867,399

Source: South Dakota Business Research Bureau

SOUTH DAKOTA GROSS SALES (All Classifications)

Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Annual Total
1982	$1,989,396,154	$	$	$	$
% Increase	-2.3%				
1981	2,035,645,321	2,329,657,567	2,384,168,752	2,500,886,670	9,250,358,310
% Increase	7.4%	14.5%	8.9%	.4%	7.4%
1980	1,895,991,184	2,034,053,301	2,188,746,929	2,491,146,672	8,609,938,086
% Increase	15.9%	-1.2%	1.6%	3.5%	4.3%
1979	1,636,043,639	2,059,261,478	2,153,911,653	2,406,158,421	8,255,375,191
% Increase	18.0%	16.4%	17.8%	18.2%	17.6%
1978	1,386,099,384	1,769,543,591	1,831,889,282	2,035,260,900	7,022,793,157

Source: South Dakota Sales and Use Tax Quarterly Report

The Effects of High Interest Rates on the South Dakota Agricultural Sector

The sharp increase in the average prime interest rate began affecting South Dakota's heavily agricultural-dependent economy in the first quarter of 1980. Farm machinery and irrigation equipment sales slipped 15.9% from the first quarter of 1979 to the first quarter of 1980 and they have not recovered since. The first quarter of 1982 farm machinery and irrigation equipment sales of $28 million was the lowest quarter of sales since 1977. They were down 27.1% from the already depressed 1981 first quarter level.

The overall economy in South Dakota follows the same pattern as indicated by the total gross sales. After experiencing average annual growth of 17.6% in 1979, gross sales slowed to a 4.3% increase in 1980 and 7.4% increase in 1981. The 1982 first quarter gross sales decreased 2.3% from the first quarter of 1981.

The sharp decline of the farm machinery and irrigation equipment retail sales and the restrained growth of gross sales in South Dakota is indicative of the heavy burden high interest rates place on an agricultural economy. High energy costs have increased the cost of production at a greater rate than agricultural prices have increased. To make up the difference, the farmer must increase his efficiency which usually means buying new equipment. As the sales figures for farm machinery and irrigation equipment indicate, high interest rates are precluding the farmers from purchasing new equipment. The question is, "how is a farmer going to make up for the difference in the costs of production and agricultural prices if he can't afford to borrow the money to upgrade his operation."

Chairman ANNUNZIO. I thank you for your very factually illuminating statement.

There is so much being said about where the blame lies. I want to assure you that the purpose of this subcommittee chairman holding these hearings is to not only get the facts, but to give the President the type of legislation that is permissive and not mandatory.

Any chief executive should never look a gift horse in the mouth, and when a legislator wants to give you something, you just take it and keep your mouth shut.

I am hoping the President of the United States will do that.

Mr. CARMAN. Mr. Chairman?

I would like to thank you also for your eloquent statement. I think you speak very well to the problems that certainly exist in South Dakota and how people are really suffering from the difficulties that are being visited upon them by the economic conditions that exist there, and I don't, for a moment, think any other member here for a moment diminishes the significance of those, and I, too, have been in places where people have lost their homes, and I, too, have understood the pain and frustration and the heartbreak when someone loses a farm, a home, and many years of hard work or generations of hard work.

At the same time, I say to you from my vantage point, anyway, two things:

One is, this recovery program that has been outlined, regardless of partisan considerations, and so forth, will work if we can bring it under control. I don't mean necessarily, at least from my perception, credit controls, as such, but it is important that everyone understand, really understand, I believe, whether this legislation is implemented or not, that unless and until we get spending under control for any programs down here, we are in for big, big trouble.

Thank you, Mr. Chairman.

Chairman **Annunzio**. Our next witness is Mr. J. Morton Davis, president of D. H. Blair Co. of New York.

STATEMENT OF J. MORTON DAVIS, PRESIDENT, D. H. BLAIR & CO., INC., NEW YORK, N.Y.

Mr. **Davis**. Thank you, Mr. Chairman.

What I am really sorry about this morning is that I am not from the 11th District, not so much that Wall Street is such a tough place to hang out these days, but because of the accolades that have been addressed to the 11th District people.

Chairman **Annunzio**. We are always happy to welcome Wall Street to this subcommittee.

Wall Street has done so much for this subcommittee. Welcome to the subcommittee.

Mr. **Davis**. I want to say to the chairman, notwithstanding the fact that I am not from the 11th District, I do want to endorse his spare tire approach.

I could not understand why anybody would not want to have a spare tire available when he is not compelled to use it; so just having it to me seems like the minimal of logic, and I thoroughly endorse that stand.

I will look over the 11th District, and think about relocating, Mr. Chairman.

I am president of an investment banking firm that has been active in underwriting new growth companies. From the perspective of Wall Street and of new growth firms, I want to tell you how high interest rates are crippling the economy and the capital markets, and what extending the Credit Control Act can do to help turn our economy around. My views have been developed in several papers that are available here and in a book that will be published this fall by Gardner Press.

As we are quickly coming to learn, high interest rates are a sure formula for economic destruction. Witness the record and accelerating rate of bankruptcies, which have totaled more in the first half of 1982 than in all of 1981. Take on top of that the large number of bank failures, many of which go unreported as such, since they are disguised as quickie mergers and bailed out at great cost to the Government and the taxpayer by the FDIC and other agencies.

At the heart of the problem are crippling interest rates, which are ruining business in several ways. First, businesses are forced to borrow heavily just to pay the interest on their debts. Almost 50 cents of every dollar of cash flow to American corporations is now going to pay off debt obligations.

I would ask the subcommittee to consider, since we have no demand for capital goods, no demand for inventory accumulation, funds for housing, where is that demand coming from?

It seems to me it is more than coincidence the increase in demand is 18 percent or approximately the rate that business is paying to the banks, so, in light of that, it seems destructive to have these high interest rates. When the banks earn all the money, and I don't take anything away from the banks, they provide a great service, but not a product, and it tends to be destructive to the entire economy when the banks are the most successful and the only industry showing incremental growth in earnings this year.

Second, current high rates force businesses to curtail their long-term investment plans—building efficient plants, installing modern equipment, or engaging in research and development. The price we are paying now is cutting off future productivity and jeopardizing our competitive position in the world markets.

Finally, high interest rates choke off consumer demand in such basic and major industries as housing and autos, whose decline in turn affects the demand for steel, copper, lead, rubber, glass, and lumber—in other words, almost all basic industrial items. Without demand, why should any businessman contemplate additional capital investment? Why consider expansion when one can't effectively use present capacity?

High interest rates have become an absolute guarantee of the failure of supply-side economics, the linchpin of President Reagan's recovery program, because they discourage the investment that supply-side policies were designed to stimulate and encourage.

One would think that President Reagan and his supply-siders would want low interest rates, and would take whatever steps are necessary to bring them about.

We need to give the President a mechanism to deal with these counterproductive conditions so that the potential success of his program is not canceled out by the totally unjustified and unnecessarily high cost of money. Money is the lifeblood of business, and when its cost becomes prohibitive, it threatens to kill, or at least cripple, the economic body.

Selective credit controls are one of the most effective and direct ways of lowering interest rates and targeting incentives at areas of the economy that we most want to see grow. They are certainly more effective than efforts to control such economic factors as the budget deficit or money supply growth and volatility, whose effect on interest rate movements is variable, poorly understood, and a matter of great controversy. Even Milton Friedman, the guru of "monetarists," has recently complained that "nobody really understands what is going on."

The fact is that present high interest rates are not only uncalled for, in light of the recession, and the absence of demand for funds for capital equipment, inventory accumulation, housing and autos, et cetera. They have little relation to credit availability. Money is around in almost limitless supply; just ask any commercial banker. That should be abundantly clear from the megadollars that have been available for acquisitions. But it is available at exorbitant and perhaps extortionist rates, so that we are for the first time experiencing the irony of expensive easy money.

Credit has become easy because of structural changes in banking operations and by bank deregulation, which have made disintermediation in commercial banks—the ultimate check on credit availability and high interest rates—a thing of the past. An article explaining this new trend is available here. I urge you to read that.

Now that there is no ceiling on what can be paid to depositors, money is borrowed at high rates only to be lent out at still higher rates in an inflationary spiral that feeds upon itself. To the extent businessmen need money to run their businesses, they keep on borrowing up and through the time that they go bankrupt. The price is irrelevant, and they have to keep borrowing, and this is the quandary that we are in now, that we have the interest rates destroying the very essence of our capitalistic system.

Because of the relative inelasticity of business demand for money, banks pass through the higher costs, such as a utility does. Just as loan sharks inevitably wipe out their clients, current usurious rates are wiping out businesses They threaten a crescendo of failure in a potential domino effect.

The obvious benefit to lenders of high interest rates explains why these rates have not dropped along with prices in the current recession. In past recessions, when the Fed tightened the supply, we had a credit crunch, and the demand for short-term funds disappeared, and we had a sharp drop in the interest rates. We have not had that this time.

The other advantage of that is that as the short-term rates drop, long-term funds become available, because all the money moves out to get higher rates, and we can then build capital and investments and equities, and so forth.

As long as we induce people to put their money into mattresses, we can't build an economy on 30-, 60-, 90-day paper. We really have reversed absolutely diametrically the supply-side economics approach. We really have induced everybody to put their money into short-term funds.

It explains why the Fed's so-called "tight money" policy is failing to have its intended effects. It explains, above all, why the Credit Control Act is especially needed now to permit the President and the Fed to carry out deflationary policies without precipitating a business depression. Credit controls can help them make money tighter without raising interest rates, and lower interest rates without necessarily increasing the money supply.

The argument that credit controls interfere with the free market process does not hold water. We are not really discussing the introduction of a new level of Government interference. The Fed already determines the level of margin requirements for common stocks; that is certainly a selective credit control. It intervenes every single day in the open market, either buying or selling Government securities to achieve some predetermined money target that it feels is best for the economy. So we are not talking about a new form of intervention. We would merely, by the introduction of this bill, insure the availability of a mechanism that would, when it was deemed necessary, permit effective and timely intervention to help the economy function more smoothly and avoid the devastation to productivity and growth that high, or even just volatile, interest rates produce.

In addition to undermining the administration's supply-side effects, ruinous interest rates have been destroying our country in several specific and clearly identifiable ways.

They are killing our most valued allies, who are telling us so and are almost begging for relief. We cannot afford to jeopardize these vital relationships.

They are killing our export markets by pushing up the value of the dollar vis-a-vis competing currencies. By pricing ourselves out of the market, we are losing, perhaps permanently, our trade position and an enormous number of jobs.

They are killing our major domestic industries and financial institutions—autos, housing, savings banks and savings and loan associations.

They are killing our capital markets and capital investments as savers opt for the "riskless" liquidity of money market funds, short-term certificates of deposit, and/or Treasuries. We can't build plant or equipment on 60- or 90-day paper that offers rates as high as that for long-term bonds.

The failure, despite the Fed's most strenuous efforts, to control credit and interest rates has produced the worst recession since the Great Depression. To avert complete disaster, the Credit Control Act should be extended, and, more important, be used selectively to encourage constructive economic activity that supports our most important social goals.

Thank you very much.

[Mr. Davis' prepared statement with attached supporting material, follows:]

STATEMENT ON EXTENDING THE CREDIT CONTROL ACT

By J. Morton Davis

President, Investment Banking firm of D.H. Blair & Co., Inc.; MBA with distinction, Harvard Business School; Member Phi Beta Kappa; B.A. Magna Cum Laude with honors in economics, Brooklyn College; Author of *How to Make the Economy Succeed* (Gardner Press, fall 1982).

Ladies and Gentlemen:

My name is J. Morton Davis. I am president of D.H. Blair & Co., an investment banking firm that has been active in underwriting new growth companies. From the perspective of Wall Street and of new growth firms, I want to tell you how high interest rates are crippling the economy and the capital markets, and what extending the Credit Control Act can do to help turn our economy around. My views have been developed in several papers that are available here and in a book that will be published this fall by Gardner Press.

As we are quickly coming to learn, high interest rates are a sure formula for economic destruction. Witness the record and acclerating rate of bankruptcies, which have totaled more in the first half of 1982 than in all of 1981. Take on top of that the large number of bank failures, many of which go unreported as such, since they are disguised as quickie mergers and bailed out at great cost to the government and the taxpayer by the FDIC and other agencies. At the heart of the problem are crippling interest rates, which are ruining business in several ways. First, businesses are forced to borrow heavily just to pay the interest on their debts. Almost fifty cents of every dollar of cash flow to American corporations is now going to pay off debt obligations. Second, current high rates force businesses to curtail their long term investment plans--building efficient plants, installing modern equipment, or engaging in research and development. The price we are paying now is cutting off future productivity and jeopardizing our competitive any commercial banker. That should be abundantly clear from the mega dollars that have been available for acquisitions. But it is available at exorbitant and perhaps extortionist rates, so that we are for the first time experiencing the irony of expensive easy money. Credit has become easy because of structural changes in banking operations and by bank deregulation, which have made disintermediation in commercial banks--the ultimate check on credit availability and high interest rates--a thing of the past. (An article explaining this new trend is available here.) Now that there is no ceiling on what can be paid to depositors, money is borrowed at high rates only to be lent out at still higher rates in an inflationary spiral that feeds upon itself. Because of the relative inelasticity of business demand for money, banks pass through the higher costs, much as a utility does. Just as loan sharks inevitably wipe out their clients, current usurious rates are wiping out businesses. They threaten a crescendo of failure in a potential domino effect.

The obvious benefit to lenders of high interest rates explains why these rates have not dropped along with prices in the current recession. It explains why the Fed's so-called "tight money" policy is failing to have its intended effects. It explains above all why the Credit Control Act is especially needed now to permit the President and the Fed to carry out deflationary policies without precipitating a business depression. Credit controls can help them make money tighter without raising interest rates, and lower interest rates without necessarily increasing the money supply.

The argument that credit controls interfere with the free market process does not hold water. We are not really discussing the introduction of a new level of government interference. The Fed already determines the position in the world markets. Finally, high interest rates choke off consumer demand in such basic and major industries as housing and autos, whose decline in turn affects the demand for steel, copper, lead, rubber, glass, and lumber--in other words, almost all basic industrial items. Without demand, why should any businessman contemplate additional capital investment? Why consider expansion when one can't effectively use present capacity?

High interest rates have become an absolute guarantee of the failure of supply-side economics, the lynchpin of President Reagan's recovery program, because they discourage the investment that supply-side policies were designed to stimulate and encourage. We need to give the President a machanism to deal with these counterproductive conditions so that the potential success of his program is not cancelled out by the totally unjustified and unnecessarily high cost of money. Money is the lifeblood of business, and when its cost becomes prohibitive it threatens to kill, or at least cripple, the economic body.

Selective credit controls are one of the most effective and direct ways of lowering interest rates and targeting credit incentives at areas of the economy that we most want to see grow. They are certainly more effective than efforts to control such economic factors as the budget deficit or money supply growth and volatility, whose effect on interest rate movements is variable, poorly understood, and a matter of great controversy. Even Milton Friedman, the guru of "monetarists," has recently complained that "nobody really understands what is going on."

The fact is that present high interest rates are not only uncalled for, in light of the recession, and the absence of demand for funds for capital equipment, inventory accumulation, housing and autos, etc. They have little relation to credit availability. Money is around in almost limitless supply; just ask the level of margin requirements for common stocks; that is certainly a selective credit control. It intervenes every single day in the open market, either buying or selling government securities to achieve some predetermined money target that it feels is best for the economy. So we are not talking about a new form of intervention. We would merely ensure the availability of a mechanism that would, when it was deemed necessary, permit effective and timely intervention to help the economy function more smoothly and avoid the devastation to productivity and growth that high, or even just volatile, interest rates produce.

In addition to undermining the Administration's supply-side effects, ruinous interest rates have been destroying our country in several specific and clearly identifiable ways.

--They are killing our most valued allies, who are telling us so and are almost begging for relief. We cannot afford to jeopardize these vital relationships.

--They are killing our export markets by pushing up the value of the dollar vis-à-vis competing currencies. By pricing ourselves out of the market, we are losing, perhaps permanently, our trade position and an enormous number of jobs.

--They are killing our major domestic industries and financial institutions--autos, housing, savings banks and savings and loan associations.

--They are killing our capital markets and capital investments as savers opt for the "riskless" liquidity of money market funds, short-term certificates of deposit, and or Treasuries. We can't build plant or equipment on 60 or 90 day paper that offers rates as high as that for long term bonds.

The failure, despite the Fed's most strenuous efforts, to control credit and interest rates has produced the worst recession since the Great Depression. To avert complete disaster, the Credit Control Act should be extended and, more important, be used selectively to encourage constructive economic activity that supports our most important social goals.

OCTOBER 5, 1981

THE NEW YORK TIMES

For Credit Controls

By J. Morton Davis and Charles M. Haar

To control inflation, the Federal Reserve, with the Reagan Administration's blessing but the occasional balking of its chief executive, has been trying to reduce the money supply by driving up interest rates. But by narrowing policy to this one option — with the consequence of limiting public discourse on the problem — the Administration forgoes alternative strategies, even those that promise to be more efficacious. Selective credit controls provide a case in point.

The costs of high interest rates are increasingly intolerable. They raise the price of money not only to private borrowers but to government: The difference between what in any event would be a historically high 10 percent interest rate and a 15 percent rate translates into an increment of $35 billion a year on a debt of $700 billion. This amount equals the entire budget cut so laboriously worked out by the Congress.

Furthermore, high interest rates are counterproductive because they enter into and raise the cost-of-living index, triggering adjustments in wage, Social Security, and other inflation-indexed payments. This direct impact also fans the inflationary anxieties of the business groups who watch these indices so apprehensively.

In the international arena, high interest rates push up the relative value of the dollar. This raises export prices, damages our competitive standing in the foreign markets, produces a balance-of-payments deficit, and leads to greater volatility in the foreign-exchange markets. Moreover, the higher rates attract foreign deposits, thereby producing added reserves and a larger monetary base, hence a larger potential money supply — the reverse of the Fed's goal.

Most recently, high interest rates have threatened the survival of savings institutions. Encouraged by the Government, they have issued long-term mortgages bearing rates far lower than the levels that must currently be paid to attract deposits. The resulting transfer of investment to money-market funds has meant that barring some other bail-out provision — the new "all-savers" certificates, whose sale is limited to 15 months, won't solve the long-term problem — savings and loan associations will be forced to sell mortgages at enormous losses. Ultimately, it will be the Government, through its various deposit-guarantee agencies, that will have to make up these deficits, a situation leading to more Government borrowing and enlargement of the money supply.

Perhaps the most widely asserted advantage of a high-interest-rate strategy — one in tune with the Administration's "survival of the fittest" philosophy — is the system's purported neutrality in the marketplace. But, one may ask, not unreasonably, what is impartial about hardships differently experienced? Many small businesses, innovative and entrepreneurial in spirit, form the hope for America's thrust for productivity and job-creation yet are unable to bid for capital as "freely" as mammoth, technologically less-enterprising corporations. Likewise, Federal, state, and local governments, the borrowers of last resort, are hardly, or at least not invariably, the most efficient users of capital. And there is no price so high that it can dissuade the Federal Government from borrowing.

An alternative strategy is the use of selective credit controls, which would pinpoint — and then restrain or eliminate — certain borrowers by careful direction rather than through the market mechanism. The huge bank loans generated by DuPont, Seagram, and Mobil as they battled in the Conoco takeover had the effect of startlingly increasing the money supply. Takeovers thus present a cardinal illustration of inflationary borrowing to which selective controls could be applied. Other areas ripe for credit regulation include stock and commodity margin transactions, the purchase of third and fourth homes and condominium units, speculative inventory loans, and loans for currency speculation.

This would not be the first time the Government stepped into the market to designate priorities. Indeed, choices are set forth by the Reagan Administration in its budget messages. They are again evident in its tax legislation, which is intended to foster capital spending and jobs, which favors rehabilitation over new construction, and which decidedly tilts toward selected industries such as oil and gas.

If instituted, selective credit controls would require only a brief time to make their impact and could then be promptly repealed, thus preserving a *laissez-faire* atmosphere. These measures, irrespective of their ideological cast, would also clearly convey the Administration's intent to cope with inflationary surges.

At the very least, selective credit controls can be used as an adjunct to a moderated-interest-rate policy. As a supplemental weapon in the Fed's armory, they would reduce the pressure of prevailing monetary policy that is forcing interest rates to sky-high levels. Together, these two strategies would enhance our chances to hold back the inflationary tides.

J. Morton Davis is president of D.H. Blair Company, investment bankers. Charles M. Haar is professor of law at Harvard University.

INTEREST RATES:
WHY DOES THIS TIME DIFFER FROM ALL OTHER TIMES?

By J. Morton Davis and Charles M. Haar

Supply-side strategists and liberal spenders alike subscribe to the belief that increased capital formation is the essence of a sound economy, bolstering America's productivity and thereby reducing inflation and improving international competitiveness. Yet the monetary and fiscal policies of this Administration have only succeeded in producing the opposite effects. Although sound in theory and valuable as policy, the new economic gospel is obviously failing and losing disciples.

Ruinous interest rates are the soft underbelly of supply-side Reaganomics, forcing consumers to delay or cut back their purchases on credit. To keep a business afloat has become the manager's number one task; today nearly fifty cents of every dollar of cash flow to American corporations goes to pay off debt obligations. Under this tragic scenario, many enterprises have failed; for those still surviving, long-term investment plans--building efficient plants, installing modern equipment, or engaging in research and development--have become economically unfeasible.

Prohibitively high short-term rates have stubbornly resisted a major recession and an actual decline in the Consumer Price Index. Like the moon controlling the tides, an easing in these rates would have pulled down mortgage rates, the costs of housing and of carrying inventory, and the CPI itself even more sharply. Such a decline would also have produced the normal recessionary effect on credit patterns: a drop in short term corporate debt and an increase in long-term sources of credit.

Why do interest rates defy their traditional response to business cycles? Common explanations--the numerous shells that conceal the elusive pea--include tight money, easy money, the deficit, volatility of the money supply, and psychological expectations. Each reason is only partly plausible, leaving even Milton Friedman--the guru of supply-siders--to complain recently: "Nobody really understands what's going on."

If tight money is responsible for high interest rates, then the prospective easing of the money supply should bring them down. It hasn't! The fear or expectation that such an easing will stimulate a renewed inflationary spiral immediately pushes rates higher. Alternatively, if easy money suggests future inflation, the indication of a tighter money supply should force rates down. It hasn't! The tighter supply merely causes greater expectation of competition for the limited supply and thus results in higher rates.

Nor does the budget deficit alone account for the outrageous rates now in effect. The Ford Administration's deficit was higher as a percent of GNP than the projections for 1983. Japan's deficit is also a higher percentage of GNP, with interest rates in the 5-6% range. As for volatility, Germany and Japan have both experienced greater monetary fluctuation without producing anything like our devastating interest rates. The flaw in expectations theory is that it ignores the fact that inflationary expectations are no more than projections of the past that must adjust to reality.

Too, the notion that the Fed's tight money policies are responsible is especially misleading. This theory implies that the Fed alone--a most visible candidate--is the culprit, and suggests that money is really tight. But this is inaccurate: money is expensive, yes, but not tight. Funds have been readily available for every conceivable undertaking--assuming one is willing to pay the price. There was no shortage of money, for example, to accomplish the frantic takeovers of multi-billion dollar oil companies, especially by one corporation brandishing a line of credit for six billion dollars.

The evasive pea lies under yet another shell: interest rates are high because powerful financial interests--the larger commercial banks, in particular--are the beneficiaries of the prevailing environment. Essentially, then, the difference between the current persistence of high rates and past tight money policies can be traced to the availability of capital to commercial banks which remain able, if not anxious, to pay increasing fees for the use of money. And this "abnormal" phenomenon runs back, in turn, to a major structural change in the banking system that has not been much discussed (or even noted) during the current controversy.

Large commercial banks have a significant vested interest in steep rates. Although their cost of funds may be higher, the banks have actively brought about those increases as part of a campaign to attract depositors. A high return accrues to the banks from each increase in interest from the float they perennially enjoy on their interest-free and low cost checking accounts, on time deposits, and even on the attractive spread between the rediscount rate at which they can borrow from the Fed and the prime, or higher, rate which they charge their customers. (In fact, the spread alone today is higher than the entire prime rate was not too long ago.)

The commercial banks' stake in inordinate rates was enhanced by the withdrawal of the Fed's Regulation Q limiting returns banks can pay depositors. When Regulation Q was in effect, if strong business expansion or inflation pushed overall interest rates above the imposed interest ceilings, banks could not compete successfully for deposits to make new loans. As depositors moved their funds out of banks into government securities or long-term corporate issues (a process fancifully called "disintermediation") banks had to cut back on their loans. While the ensuing credit crunch was painful, it brought an abrupt halt to the supply of funds, slowed money growth, and with it inflation. As business activity was forcefully checked, credit demand receded and was followed naturally by a quick decline in interest rates. Under those circumstances the banks served as disinterested equilibrators between the supply and demand of funds.

The changes crept in on little cats' feet. During the credit crunches of 1966, 1969-70, and 1973-74, commercial banks resorted to heavy Eurodollar borrowing, to commercial paper issued by bank holding companies, and to large $100,000+ CDs. Then, ingenious efforts at circumvention led to countervailing measures. In 1973, Regulation Q ceilings were removed from the large CDs. In 1978, limits were also lifted from small deposits on the thesis, heartily advocated by the banks, that the small saver was a victim of discrimination. The resulting creation of six-month ($10,000+) money market certificates, offering yields tied to Treasury notes, effectively checked disintermediation during the 1978 credit crunch. The 1980 Depository Institution Deregulation Act promised more: all interest rate ceilings are scheduled to be phased out over the six years following the passage of the act.

So released, banks can now attract funds no matter how high the rates soar. With the eventual elimination of state usury laws and other limitations, or their preemption by the federal regulations, banks will be able to charge what the traffic can bear.

What is to be done? The Administration and Congress should take the following steps:

1. Reinstitute gradually a ceiling on interest rates for deposits so that the Fed can again control what the banks have available to lend out. Small savers have been hurt far more by high interest rates on loans than they ever were by low returns on deposits.

2. Pressure the Fed to limit the maximum spread banks can earn between the rediscount and prime rates. A clear redefinition of the prime rate which ties it directly to the rediscount rate would ensure that borrowers receive all the cost savings from rates reduction.

3. Establish a reserve requirement on money market funds, which now exceed $200 billion. Since a substantial portion of the money market fund's portfolio is invested in large CD's issued by the banks, ceilings on interest rates for deposits would substantially reduce the yields of these funds. A proper reserve requirement on money market funds would further lower yields--while providing a margin for safety. It could also induce people to move money out of these "mattress" accounts into constructive, long-term investments.

4. Introduce targeted selective credit controls temporarily, in such non-productive areas as commodity speculation (although this recession is not an appropriate time). Banks would be required to set aside much higher reserves against such

nonproductive loans, and against advances made for mergers and acquisitions, real estate, or securities. They would also be curbed by imposing a limit on the sum of such loans as a percentage of a bank's total lending.

The argument for government nonintervention is as irrelevant as the rhetoric canonizing the free market. Commercial banks have been granted the power to create money and to profit from that license in compensation for efficient and disinterested intermediation between supply and demand of funds. In return for these sweeping powers, the government has reserved--at least since a 1911 opinion by Justice Holmes--the right to regulate this "great public need." The failed experiment of phasing out Regulation Q, bucking this seventy-year trend, teaches us a crucial lesson: commercial banks operating without proper supervision are in effect granted the power to govern. When large commercial banks have become so preoccupied with their own profit as to make the tariff of intermediation a constrictive torniquet, society must intervene.

Each day the need for lower interest rates becomes more urgent. Major businesses are suffering devastating earnings declines--even bankruptcy. Thrift institutions are threatened with massive insolvency. Lower short-term interest rates can make Reaganomics work, though at some cost to ideological purity. The Administration can hardly afford to wait any longer for commercial banks voluntarily to lower the interest rates; it must take steps to drive them down.

If these steps are implemented interest rates, just as the cost of gold, silver and other commodities have, will come tubling down.

Chairman **Annunzio**. Thank you very much, Mr. Davis, and I would like to thank you for a very excellent scholarly statement. Mr. Davis is president of the investment banking firm of D. H. Blair & Co., and has an MBA with distinction from the Harvard Business School, and is a member of Phi Beta Kappa, Magna Cum Laude, with honors in economics at Brooklyn College.

He wrote a book entitled "How To Make the Economy Succeed," and God knows, we need something today to make this economy succeed, and I am deeply grateful for your scholarly presentation, to have your views, and to welcome you before the subcommittee.

It is always good to have somebody from Wall Street on your side of the aisle.

Mr. **Davis**. Thank you very much, Mr. Chairman, and members of the subcommittee.

Chairman **Annunzio**. Our next witness is an old distinguished friend of mine from the American labor movement.

For the benefit of my minority leader, Mr. Paul, this man was born in Jack Brooks' district in Beaumont, Tex. He is the general president of the International Union of Operating Engineers, the union that represents over 420,000 skilled workers.

Most of his members operate heavy equipment in the construction industry.

It is a pleasure to welcome you before the subcommittee, and you may proceed in your own manner with your statement, which has already been made part of the record.

STATEMENT OF J. C. TURNER, GENERAL PRESIDENT, INTERNATIONAL UNION OF OPERATING ENGINEERS, AND CHAIRMAN, NATIONAL COUNCIL FOR LOW INTEREST RATES

Mr. **Turner**. Thank you very much. It is a great pleasure to be here today to tell the subcommittee our views, and also those of the National Council for Low Interest Rates.

Monday, I was with Joe Keenan, and he said for me to tell you hello.

Chairman **Annunzio**. He is a great friend.

Mr. **Turner**. One of the members of our Council is here with us, the general president of the Carpenters International Union, and also a vice president of the AFL-CIO, and, with your permission, I would like to call your attention to Mr. Bill Conyha, sitting right over there.

Chairman **Annunzio**. Thank you. Welcome before the subcommittee, and we are happy to have you here.

Mr. **Turner**. I am testifying on behalf of the International Union of Operating Engineers, a union that represents more than 420,000 skilled workers. Most of our members operate heavy equipment in the construction industry.

I am also testifying on behalf of the National Council for Low Interest Rates, a broad-based coalition of organizations dedicated to achieving interest rates that are low enough to permit the economy to function properly and move toward full employment, to provide adequate credit for productive uses, and to allow American families reasonable access to home mortgages.

The Council's members include the Consumer Federation of America, U.S. Conference of Mayors, the National Housing Conference, the National Association for the Advancement of Colored People, the Rural Electric Cooperative Association, the American Public Power Association, the United Auto Workers, the United Brotherhood of Carpenters and Joiners, and the General Contractors of New York, and the Industrial Union Department of the AFL-CIO, and, of course, our union.

I am not going to go into a lot of detail about matters that have been covered adequately by other members of the panel, and I have not heard anything with which I disagree in their presentation, so I will not take up that kind of time, but I think, Mr. Chairman, that we have to recognize that these high interest rates are undercutting our ability to function as a society.

The construction industry has been especially hard-hit by the scourge of high interest rates. Unemployment among the skilled workers in the building trades has been running at a rate above 20 percent, more than double the national level. Even that figure, severe as it is, does not reflect the depth of the hardship being inflicted on construction workers in many parts of our Nation.

In the State of Michigan, 60 percent of our members—we have 18,000 members in Michigan—and 60 percent of them are out of work. In the State of Ohio, where we have approximately 17,000 members, 40 percent are out of work, and it is, as far as the building trades are concerned, Mr. Chairman, it is not a recession; it is truly a depression.

In order to bring down interest rates compatible with healthy economic growth, we strongly support Chairman St Germain's bill, H.R. 6124, which is cosponsored by our chairman today, Congressman Annunzio.

The Low Interest Rate Act of 1982 is what it is called.

Chairman St Germain's bill, along with the Senate companion introduced by Senator Alan Cranston's S. 2526, extends and improves the Credit Control Act of 1969.

We are convinced that the use of the Credit Control Act offers the only avenue available for removing the crucial burden of high and volatile interest rates.

The Low Interest Rate Act extends the ability of the President to authorize the Federal Reserve Board to control credit. It improves the "trigger" for the use of that authority by including considerations of recession and unemployment—the current products of our Nation's monetary policy—in addition to the original consideration of the act for preventing or controlling inflation. There can be no doubt that these additional triggering criteria are appropriate in today's climate.

The St Germain bill further improves on the 1969 act by explicitly authorizing the Federal Reserve Board to "ensure the availability of credit for productive and necessary purposes," specifically by prescribing "limitations with respect to credit for nonproductive purposes, including corporate takeovers."

We consider these tremendous improvements from the old bill which has expired.

On corporate mergers and their impact on the demands for credit, our coalition published just last month a study by Steve Brobeck, executive director of the Consumer Federation of America, and a member of the steering committee of the Low Interest Rate Council.

Our report, "The Merger Boom and High Interest Rates," summarizes the impact on credit markets of the current wave of corporate takeovers and the massive use of loan capital and lines of credit to finance these mergers. By 1981, merger activity had reached an all-time high, rising from $11.8 billion in 1975 to $44.3 billion in 1980, and finally to $82.6 billion in 1981. Lines of credit held open in our Nation's banks to finance planned mergers by these blue-chip corporate borrowers tied up an estimated $70 billion.

The estimated $34 billion in merger-related bank loans exceeded all new loans to State and local governments in that year.

These merger loans and lines of credit for these nonproductive investments squeeze out productive users of credit such as industry, housing, farmers, utilities, and State and local governments.

I note your chart identifies some of these things. The projected Federal deficit of $100 billion or more is considered by many to be irresponsibly expansionary. We note each 1 percent of unemployment adds $27 billion to that Federal deficit, and that a 4-percent reduction of unemployment, 9.5 percent of the work force, to 5.5 percent, would produce a Federal budget surplus of several billion dollars.

At 4.5-percent unemployment, the present budget would be producing a surplus of more than $30 billion.

We are tired of the blunderbuss approach of this administration. We believe that the Congress has to impose some fine-tuning on this administration in terms of trying to prime the pump and get America back to work.

Whether we like or dislike these facts, the macroeconomic parameters are basically fixed. We find continuation of this punishing, irrational recession, what I call a depression, intolerable.

The one alternative we see—and the one support—is the tilting of available credit for the productive uses as provided in H.R. 6124.

Three weeks ago, I was in England and attended a meeting of the British North American Committee, including Canada, the United States, and England. I had been trying for several months to get a compilation of the laws and regulations governing central banking systems around the world, particularly in the western democracies. At the meeting they distributed such a study which had been done by the Government of Great Britain and which was distributed by the British-North American Committee, and a copy of that has been given to all of you. I think the information is extremely interesting.

Chairman ANNUNZIO. Without objection, if you will submit that survey to the court reporter, it will be made part of the record.

[The survey referred to by Mr. Turner follows:]

British-North American Committee

BN/PG: 16
Staff Report
Central Banks &
Government
May 1982

RELATIONS BETWEEN GOVERNMENT AND CENTRAL BANK:

A Summary of a survey of 20 Countries

Circulated at the request of the Planning
Group on World Monetary Affairs.

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BACKGROUND

At its meeting in Palm Beach, the Planning Group on World Monetary Affairs requested a background paper on the differences in relationships of Central (Reserve) Banks and Governments.

This paper consists of a survey which was published as Appendix 8 of the final *Report to the Committee to Review the Functioning of the Financial Institutions* (HMSO Cmnd 7937) which was set up by the UK Government in 1977 under the Chairmanship of Sir Harold Wilson and which reported in 1980.

The Planning Group meets at 11.40 am on June 18th 1982 in the Haldon Room of the Imperial Hotel, Torquay.

Relations between government and central bank: a survey of twenty countries[1]

1 IS THE CENTRAL BANK THE CHIEF EXECUTANT IN THE MONETARY FIELD OF CURRENT ECONOMIC POLICY? (Regardless of whether policy is determined by the central bank or elsewhere)	In all the countries, the central bank is the chief executant in the monetary field of current economic policy. However, in some countries, certain functions are shared with other institutions: AUSTRALIA —Exchange rate fixed by triumvirate consisting of Governor of the Reserve Bank, Secretary of the Treasury and Secretary of the Prime Minister's Department. BELGIUM —Responsibility for open market operations shared jointly with Ministry of Finance. GERMANY —Regulation of inflows of foreign capital shared with government.
2 DOES THE CENTRAL BANK HAVE A STATUTORY DUTY TO PURSUE CERTAIN STATED ECONOMIC OBJECTIVES?	
Countries where the central bank has no statutory obligations	BELGIUM, ITALY, NORWAY, SWEDEN.
Countries where the central bank has a general statutory duty to promote the welfare of the country or the government's policy	AUSTRALIA, CANADA, GERMANY, HUNGARY, JAPAN, NETHERLANDS, NEW ZEALAND, SOUTH AFRICA, SPAIN, SWITZERLAND.
Countries where specific goals are set for central banks by statute	
(i) Maintaining domestic value of the currency	AUSTRALIA, AUSTRIA, CANADA, DENMARK, GERMANY, NETHERLANDS, SWITZERLAND, USA.
(ii) Controlling external value of the currency	AUSTRALIA, AUSTRIA, CANADA, DENMARK, NETHERLANDS, SWITZERLAND.
(iii) Control of credit expansion	AUSTRIA, DENMARK, FRANCE, HUNGARY, JAPAN.
(iv) Supervision of banking system	FRANCE, GERMANY, NETHERLANDS, UK, USA.
(v) Other	AUSTRALIA and SWITZERLAND—full employment; CANADA—stability of production, trade, prices and employment; FINLAND—stability and security of monetary system and facilitation of money circulation; GERMANY and NETHERLANDS—facilitation of money transmission; HUNGARY—supporting government's five year plan.

— U.S.
The Humphrey
Hawkins?

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[1] Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hungary, Italy, Japan, Netherlands, New Zealand, Norway, South Africa, Spain, Sweden, Switzerland, UK, USA. The Committee are indebted for this appendix to Mr D E Fair of the Royal Bank of Scotland Group.

3. ARE THE CENTRAL BANK'S ACTIONS IN PURSUING THESE OBJECTIVES SUBJECT TO REFERENCE TO OR APPROVAL BY ANY BRANCH OF GOVERNMENT?		**In all countries, the central bank operates at least in consultation with the Ministry of Finance/Treasury/ government.**
Countries where central bank must keep government informed of its policies	**AUSTRALIA**	—Legal obligation to keep government informed of its policies.
	CANADA	—Legal obligation to consult regularly with Department of Finance.
	DENMARK	—Must report to government via Minister of Economic Affairs on major changes in monetary policy.
	SOUTH AFRICA	—Must consult with the Treasury/Department of Finance.
	USA	—Federal Reserve must report twice a year to Congress on its policies—*not* to President or Executive; in practice it is in continuous contract with all policy making bodies of the government.
Countries where central bank subject to general directions of government	**AUSTRIA**	—Central bank must pay due regard to economic policy of federal government.
	FRANCE	—Ministry of the Economy through the Treasury Directorate dictates even the day to day conduct of monetary policy
	HUNGARY	—Central bank is responsible to President of the Council of Ministers; in practice credit policy first agreed with Minister of Finance.
	ITALY	—Supervised by Treasury any monetary policy measures must be approved by the Interministerial Committee for Credit and Savings (CCS) to which central bank is subordinate.
	NEW ZEALAND	—In carrying out economic policy, actions may be subject to direction by Minister of Finance.
	SPAIN	—All measures subject to approval of Ministry of Economy.
	SWEDEN	—Formally central bank' is an agent of the Riksdag and independent of the government. In practice measures taken are subject to the approval of Ministry of Budget and Economics, (in addition central bank collaborates with National Debt Office which is also directly subordinate to the Riksdag).
	UK	—Subject to directions of Treasury, in practice decisions reached jointly.
Countries where central bank must obtain specific government approval for particular policies	**BELGIUM**	—Open market policy carried out jointly with government—which may impose its views. Minister of Finance has right to veto in certain limited cases.
	FINLAND	—Changes in official discount rate require approval of Parliamentary Banking Committee; otherwise central bank independent of government.
	JAPAN	—Changes in banks' reserve ratios require approval of Minister of Finance, discount rate and open-market operations policy independently determined—in practice the Ministry of Finance is likely to exercise a strong influence on all policy aspects.
	NETHERLANDS	—Exchange rate and note issue fixed by Minister of Finance with central bank advice. In other respects the Bank is independent, although its actions must not conflict with government objectives.
	NORWAY	—Changes in banks' reserve ratios must be approved by the King in Council; Discount rate in theory fixed by central bank, but in practice after consultation with Ministry of Finance.
Countries where central bank is largely independent of government in the pursuit of its statutory duties	**GERMANY**	—Bundesbank independent of Federal Government in determining e g discount, credit, open-market and minimum reserve policies. Federal Government may ask for decisions to be deferred for up to two weeks.
	SWITZERLAND	—Constitutionally central bank is completely independent of Bundesrat. The bank and the government are legally obliged to consult each other before implementing policies, although in neither case is approval necessary in pursuit of specific policies.

4. IF THE CENTRAL BANK IS INDEPENDENT IN ANY IMPORTANT RESPECT IS IT ABLE TO PURSUE OBJECTIVES THAT CONFLICT WITH THOSE OF THE GOVERNMENT? DOES IT DO SO? IF SO, HOW IS THE CONFLICT RESOLVED?

Countries where central bank has openly acted contrary to the government's economic objectives	**CANADA**	—Following the forced resignation of the Governor of the Bank of Canada in 1961 (due to his pursuing a tight monetary policy in opposition to the government's wishes) the power to issue directives to the Bank was conferred on the Minister of Finance by the addition of S14 to the Bank of Canada Act 1967; such directives must be published in the *Canada Gazette* and laid before Parliament within 15 days—this procedure has never been invoked, as in practice the Bank does not pursue policies that conflict with government objectives.
	GERMANY	—Bundesbank's obligation to support government's general economic policy is limited by the proviso that it has its own duties to discharge in safeguarding the currency. Conflicts have occurred but these have not been major or prolonged and are kept to a minimum by the division of roles—the government being mainly responsible for fiscal and exchange rate policy and the Bundesbank for monetary policy. Thus although the government has temporary blocking power in Bundesbank decisions, this has only been used on a few occasions.
Countries where such a situation is unlikely to arise:—		
(i) Because the government has complete authority over the central bank	AUSTRIA, DENMARK, FRANCE, HUNGARY, ITALY, JAPAN, NEW ZEALAND, SOUTH AFRICA, SPAIN, SWEDEN.	
	AUSTRALIA	—Should differences of opinion exist the government has statutory power, after due process of consultation to direct Reserve Bank to carry out a given policy, Parliament being informed within fifteen sitting day.
	BELGIUM	—Although forbidden to pursue targets conflicting with general objectives of government, in practice National Bank is largely independent e.g. in 1978 it reduced its financing of the government and thus forced it to finance its budget deficit by borrowing abroad.
	NETHERLANDS	—Minister of Finance may issue binding directives to Nederlandsche Bank in order to co-ordinate the policies of the two bodies.
	NORWAY	—No independent *action* in conflict with government policies by central bank since 1920's, but its staff have publicised their disagreement with government policies e.g. recently on prices and incomes policy.
	UK	—Although general policy subject to Treasury approval a measure of independence is maintained and disagreement with government policies has occasionally been publicised.
(ii) Because the central bank is independent of Government	**FINLAND**	—In theory the central bank could act in conflict with the government; in practice close co-operation makes such a situation most unlikely.
	SWITZERLAND	Potential conflicts limited because directors of the Swiss National Bank are elected by the Bundesrat.
	USA	—Although formally independent of government, the Chairman of the Board of Governors represents the Federal Reserve in discussions with the government; possible policy conflicts are discussed in various forums that typically include the Secretary of the Treasury, Chairman of the Council of Economic Advisers and the Director of the Office of Management and Budget.

5. POWERS OF GOVERNOR AND DIRECTORS: TERMS OF OFFICE, INTERESTS REPRESENTED, METHODS OF REACHING DECISIONS

AUSTRALIA	—Governor and Deputy Governor appointed by the government (Governor-General) for seven years. Seven other Board members similarly appointed for five years except that not more than two of the seven may be officers of the Reserve Bank or public service and hold office for an unspecified period. None may be directors or employers of any other bank. All are eligible for re-appointment. Board members are usually selected for their eminence in academic, agricultural or general business activity. The Secretary of the Treasury is an *ex-officio* member of the Board. Six members, including the Governor or Deputy Governor, are required for a quorum of a meeting of the Board. Decisions are by a simple majority of members present. The Chairman of the meeting has both a deliberative and a casting vote.
AUSTRIA	—President: appointed by Federal President for a five-year term, may be re-appointed. Two Vice-Presidents and 5 of the 11 other directors similarly appointed. Six remaining directors elected by the General Assembly of Shareholders for periods of five years; they may be re-elected. Directors must be economic experts or outstanding persons in the business community. The Board must include at least one representative of: banking institutions, savings banks, industry, trade and small business, agriculture and one representative each of salaried employees and labour. In practice, balance is also maintained between the political parties. Board of Directors supervises and directs Bank's entire conduct of its business. President has casting vote. A separate Board of Managers (consisting of a General Manager, Deputy General Manager and 2–4 other managers) is charged with the operation of the Bank. It is appointed by and reports to Board of Directors. President may attend its meetings and has the casting vote.
BELGIUM	—Governor: appointed by the King (i.e. the government) for five years (although he may be suspended for up to three months during this period or dismissed). He may be re-appointed. 3–6 directors appointed by the King on the proposal of the Council of Regency for six years, renewable. Governor presides over Board of Directors, Council of Regency and General Council. The Bank is managed by the Board of Directors which may change the discount rate and rate for advances in a case of emergency but must refer the matter to the Council of Regency. The Council of Regency is composed of the Governor, the Directors and 10 Regents representing wide socio-economic interests (it is legally required to include three Regents nominated by the Minister of Finance, two executives from financial institutions of public interest, two Regents proposed by trade unions, and three proposed by organisations most representative of industry, commerce and agriculture). Balance is also maintained between the two linguistic groups. The Council deals with general questions pertaining to the Bank, currency, credit and the economy. It fixes the rate and terms of discounts, advances and loans. Its decisions are by majority vote, with the Governor having a casting vote. Its members are elected for terms of three years by AGM of shareholders (which otherwise has a purely formal role). The Board of Censors consists of 8–10 members specially qualified in the field of financial supervision, similarly elected. The Censors approve the balance sheet and expenditures by majority vote. General Council formed from Governor, directors, regents and censors and considers the general administration of the Bank and the issue of bank notes. Governor has the deciding vote. Government Commissioner: The Minister of Finance has the right to control all the Bank's operations; this control is entrusted to a Government Commissioner who is entitled to attend the AGM and meetings of the Boards, Council and Committees in an advisory capacity.

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CANADA	—Governor: appointed by directors (with approval of Governor-General in Council i.e. the Government) for seven years during "good behaviour". He is eligible for re-appointment. Twelve Directors appointed by Minister of Finance (with approval of Governor-General in Council) for terms of three years; they may be re-appointed. There is a general requirement that directors be selected from "diversified occupations", in practice different regions of Canada also represented. Directors or officials of chartered banks and of investment houses acting for the Government may not become Bank of Canada directors. Responsibilities stop short of technical decisions with respect to monetary policy (which are left to the Governor), the directors being more concerned with the internal functioning of the Bank.
DENMARK	—Governor: appointed by the Sovereign (i.e. the government), remains in office until 70 years old. Two Deputy Governors: appointed by Board of Directors. None of the Governors are on the Board of Directors. Twenty-five Directors: eight with seats in Folketing; one economist and one lawyer appointed by Minister of Trade, Industry and Shipping (who in his capacity as Royal Bank Commissioner presides over meetings of the Board of Directors). Fifteen elected by the Board of Directors in rotation (three per year). All directors serve five-year terms. The elected Board members are required to represent all sectors of the economy, including labour and regional areas, but may not attend to the interest of any particular group of the community. The three-man Board of Governors reports to the Board of Directors. This latter elects a Chairman (who has a casting vote) annually from amongst its 25 members and deals with more fundamental issues affecting the Bank. A Committee of Directors which must comprise the two nominees of the Minister (who will also attend its important meetings) and five other members of the Board of Directors, elected annually from among the members, keeps itself informed of the more important aspects of the Bank. The Chairman of the Committee of Directors is also elected annually. All three bodies reach decisions by a majority vote, the Chairman having a casting vote in the event of a tie.
FINLAND	—Governor: appointed by President of the Republic at the suggestion of the Parliamentary Banking Committee, for an indefinite term. Four members of the Board of Management similarly appointed, may be suspended by the group of nine Parliamentary Bank Supervisors selected by the Diet from among its members. There is no requirement that particular interests be represented. Administration and management in the hands of the Board of Management, subject to review by the Bank Supervisors. The Chairman (Governor) of the Board of Management has the casting vote.
FRANCE	—Governor: appointed by President in consultation with the cabinet, for an indefinite period and may be dismissed by the President. (In the past Governors have served until retirement but, departing from tradition, the present Governor has been appointed for a term of five years). Two Deputy Governors, similarly appointed. There are 13 members of the General Council: the Governor and the deputy governors and 10 others. The latter 10 consist of nine appointed by the Council of Ministers on nomination by the Minister of the Economy and one elected from and by the personnel of the Bank. They are appointed for six years. All councillors may be re-appointed until the age of 65. An auditor and his assistant also sit with the Council in an advisory capacity. The 46 man National Credit Council has a similar role to Boards of Directors in other countries. It is presided over by the Minister of the Economy, the Governor of the Bank of France acting as vice-president, and comprises in addition to these 13 members appointed by the Minister of the Economy, seven representing government departments, nine trade union representatives, eight representatives of financial and banking institutions and seven from public credit institutions. Management of the Bank's business is in the hands of the Governor and two Deputy Governors. The General Council supervises all branches of the Bank's activities. Decisions are taken by a simple majority. Although the two auditors cannot vote, their approval is generally necessary.

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GERMANY	—Governor: appointed by President on nomination by federal government, which in turn consults Central Bank Council, for a term of eight years (exceptionally for a shorter period but in no case less than two years). The Directorate comprises not more than 10 members, similarly appointed. —The Central Bank Council consists of the Directorate together with the presidents of the 11 "Land" central banks, who are nominated by Parliament on proposals from the appropriate authority of the Land concerned, for eight-year terms subject to the possibility of re-appointment. Regional representation is effected through the Land Central Bank Presidents, other directors are required to be particularly qualified in their field. The Central Bank Council determines monetary and credit policies of the Bank and may issue instructions to the Directorate or Boards of Management of the Land Banks; it takes decisions by simple majority. The Directorate implements the decisions of the Central Bank Council, and deals with the administration of the bank, its decisions are also by simple majority, the President having a casting vote.
HUNGARY	—President of the Bank and his deputies appointed by the Council of Ministers, for an indefinite period. The President of the Bank in turn appoints the directors, who hold their office for an indefinite term. The Board of Management typically includes representatives of the National Planning Office, Ministry of Trade, etc. It has a particularly important role in deciding whether the country should borrow substantially from abroad. In all decisions of the Board the President has an overriding power.
ITALY	—Governor: appointed by Board of Directors (not necessarily from amongst their number) subject to approval of Council of Ministers and President of the Republic, for an indefinite term. Thirteen directors elected by General Meetings of Shareholders at 13 regional offices of the Bank, for three-year terms, the directors are eligible for re-election. Board of Directors is charged with general administration of the Bank under the chairmanship of the Governor who has a casting vote. The business of the Bank is managed by the Governor and a Committee of the Board of Directors comprising the Governor and four of the Directors appointed annually by the Board. A representative of the Minister of the Treasury may participate in meetings of the Board of Directors as an observer; he is empowered to suspend the implementation of any decision which he considers contrary to the law, regulations or statutes of the Bank for up to five days.
JAPAN	—Governor: appointed by the Cabinet for a term of five years, he may be re-appointed. Vice-Governor, similarly appointed. Seven Policy Board members include the Governor and two representatives of the Economic Planning Agency and the Ministry of Finance. The other four members must consist of two with financial experience, one with industrial experience and one with agricultural experience. They are appointed by the Cabinet with the consent of both houses of the Diet for four-year terms; they may be re-appointed. The Policy Board directs and supervises the business of the Bank. The two government representatives on the Board do not have voting rights, and decisions are taken by majority vote of those having voting rights.

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NETHERLANDS	—President: appointed by the Queen on the advice of the Minister of Finance (from a choice of two candidates put forward by a joint meeting of the Governing Board of the Bank and the Board of Commissaries) for seven years, he may be re appointed. Governing Board consists of the Governor, the Secretary and 3-5 directors similarly appointed for seven years. Twelve members of the Board of Commissaries are appointed by the Queen from a short-list of three for each place, drawn up by a joint meeting of the Governing Board and Board of Commissaries. Seventeen members of the Bank Council include a Royal Commissioner, representing the government, and four Commissaries; the 12 other members must include representatives of the government, commerce (including transport), industry and agriculture, labour unions and the monetary and credit sector. The Governing Board is charged with the administration of the Bank, and is supervised by the Board of Commissaries. Governor of the Bank reports to the Bank Council on Bank policy and general economic and financial conditions. The Bank Council is authorised to offer independent advice to the Minister of Finance on Bank policy.
NEW ZEALAND	—Governor: appointed by the Governor General in Council on the recommendation of the Minister of Finance, for a term of five years, he is eligible for re-appointment. Deputy Governor similarly appointed. Seven Directors similarly appointed. The Secretary of the Treasury is a member of the Board. Appointments are intended to reflect a diversity of interests, including industrial or commercial experience. Decisions are by consensus.
NORWAY	—Chairman of the Board of Directors: appointed by the King on the advice of the Supervisory Council (in effect by the government), for an indefinite term but subject to dismissal. Vice Chairman, similarly appointed. Three other directors are elected by the Storting for six year terms; they may be re-appointed. Fifteen members of the Supervisory Council are also elected by the Storting for six year terms. There is no requirement that particular interests be represented on either the Board of Directors or the Supervisory Council. Administration of the Bank is in the hands of the Board of Directors, but subject to decisions of the Supervisory Council. The Chairman (Governor) of the Board of Directors has a casting vote. The Chairman of the Supervisory Council (elected annually from amongst its members) also has a casting vote.
SOUTH AFRICA	—Governor: appointed by President on advice of Minister of Finance for five years; he may be re-appointed. Three Deputy Governors similarly appointed. Two Directors similarly appointed for three-year terms. Six remaining directors elected for three year terms by Annual General Meeting of Shareholders; they are eligible for re-appointment. Traditionally a wide spectrum of interests is represented. Directors are expected to resign if a conflict of interest arises. Decisions are taken by a simple majority of the Board with the Governor having a casting vote.
SPAIN	—Governor: appointed by the government on the proposal of the Minister of Finance, for an unspecified term. Two or more Deputy Governors, also appointed by the government on the proposal of the Minister, for three-year terms, renewable. Administration is in the hands of the Board of Directors which comprises the Governor, his Deputies and three members of the General Council selected by the Minister of Finance from amongst those Councillors designated by the government. General Council consists of the Governor and his Deputies plus 14 others: five members designated by the government representing the general interests of the national economy, two representatives of credit institutions, two representatives of the savings banks, four representatives of the trade unions, one representative of the Bank's staff. All are appointed for an unspecified term. The General Council approves the balance sheet and advises the government. The Governor is chairman of both bodies and has a casting vote on each.

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SWEDEN	—The Governor of the Bank is elected by the Board of Directors from amongst their members. He is not the Chairman of that board. No fixed term but up to age 70. Deputy Governor elected by Directors either from among themselves or from outside. The Chairman of the Board of Directors is appointed by the King in Council for a term of three years; he may be re-elected. Deputy Chairman similarly appointed. Five directors elected by the Riksdag, also for three year terms, subject to re-appointment. There is no legal requirement that particular interests be represented on the Board. A Cabinet Minister or Director of the National Debt Office may not be a member of the Board. The Bank is administered by the Board of Directors. Five directors constitute a quorum; but if a motion is opposed all must attend the meeting, the decision being taken by a simple majority vote, the Chairman having a casting vote in the event of a tie.
SWITZERLAND	—The three members of the Board of General Managers (the Governor and two deputies) are appointed by the Bundesrat for six years; they may be re-appointed. Twenty-five members of the Bank Council are similarly appointed for four years; 15 other members of the Council are elected by shareholders of the Bank; all are eligible for re-appointment. The 40 members of the Bank Council must be chosen to represent geographical regions and various sectors of the economy. Supervision and control is in the hands of the Bank Council (which is responsible to General Meeting of Shareholders). More detailed day-to-day supervision and control of the Bank's management is carried out by the Bank Committee, which consists of the Chairman and Deputy Chairman of the Council together with some eight other members appointed by the Council. The Chairman of the Bank Council is also Chairman of the Bank Committee, and in the case of a tied vote in the Committee, the Chairman's vote counts double.
UNITED KINGDOM	—Governor appointed by the Crown (i.e. the government) for five years, he may be re-appointed. Deputy Governor similarly appointed. Sixteen directors similarly appointed by the Crown for four year terms; four retiring in rotation each February, not more than four of these may be full time (executive) directors. The 12 non-executive directors are appointed from a variety of interests in industry and commerce, trade union affairs and banking (they may not be a member of the House of Commons, a minister of the Crown or working in a government department). The Governor plays the most important role in instituting and formulating advice or proposals to the government, and in the day-to-day business of the Bank. The Governor may call for advice from individual directors or from standing committees of the Court of Directors.
USA	—The seven members of the Federal Reserve Board are appointed by the President, with the approval of the Senate, for fixed terms of 14 years, non-renewable. The President designates two members of the Board to be Chairman and Vice-Chairman respectively, for four year terms, renewable. By tradition, the members of the Board are selected in order to maintain a geographical balance and both bankers and non-bankers are included. They must all be members of a Federal Reserve district bank board. The directors of these regional Reserve Banks are composed of equal numbers of Class A directors (representing member banks), Class B directors (non-bankers) and Class C directors. Classes A and B are elected by member banks, but Class C are appointed by the Federal Reserve Board, and of these Class C directors the Board appoints the regional Chairmen and Vice-Chairmen. Major monetary policy decisions are made by the Federal Open Market Committee, which consists of the members of the Board, plus the Presidents of five regional Reserve Banks who serve one-year terms on a rotating basis, (except the President of the Federal Reserve Bank of New York who is always a member and, by tradition, the Vice Chairman of the FOMC). The Chairman of the Board is also Chairman of the FOMC. In theory, each regional Reserve Bank can determine the discount rate applicable to the short-term loans it makes to its members, subject to review and determination by the Board; when the system was first set up it was thought that differing regional credit conditions would lead to differing rates. In practice, however, the integration of regional markets into one national market, and the establishment of national economic goals, have meant that the Board accepts only one national discount rate. The regional policies on the use of the discount window are also co-ordinated by periodic meetings of the Reserve Banks' lending officers. The decisions of the Board are reached by a simple majority vote.

6. IS THERE AN INTER-CHANGE OF STAFF OR LIAISON BETWEEN THE STAFFS OF THE CENTRAL BANK AND THE TREASURY/ MINISTRY OF FINANCE?

Countries where this takes place

AUSTRIA —Occasionally on a personal basis. Also the Ministry of Finance frequently relies upon the National Bank's expert advice.

CANADA —Considerable informal liaison and although no formal interchange of staff this does occur infrequently; two of the most senior Finance officials at present had earlier been in the Bank.

FRANCE —Little liaison occurs, although it has become established that one of two Vice-Governors will be appointed from the Treasury.

HUNGARY —Constant liaison.

ITALY —Central bank staff are frequently loaned to government departments, as well as taking personnel from them on secondment.

JAPAN —In addition to the Minister of Finance's representative on the Policy Board, a number of Bank directors have also come from the Ministry.

NETHERLANDS —Limited contact takes place at the highest level at informal meetings, and among lower echelons, by means of *ad hoc* committees.

NEW ZEALAND —Some short-term secondments for experience.

SOUTH AFRICA —Liaison and interchange of staff.

UK —No formal agreements for an interchange of staff between the Bank of England and the Treasury. However, there is constant liaison between them at all levels and secondment of staff is fairly common.

USA —There is some interchange of staff between the central bank and the US Treasury. In addition there are numerous committees that provide formal liaison between the two organisations.

Countries where contact is limited

BELGIUM, DENMARK, SPAIN.

AUSTRALIA —To a limited extent, also the Secretary of the Treasury is a Board member.

FINLAND —Insignificant, though close high level contact with the Ministry of Finance exists.

GERMANY —No formal liaison or interchange of staff; however, members of the two institutions work closely together in national and international bodies such as the IMF.

NORWAY —Contact limited to joint membership of inter-ministerial committees.

SWEDEN —Some members of staff have worked in both institutions.

SWITZERLAND —Some members of staff have worked in both institutions but there are no formal arrangements for exchange or liaison.

7. IS THE CENTRAL BANK OR ITS GOVERNOR MADE ACCOUNTABLE TO PARLIAMENT? IN WHAT WAY?

Countries where central bank is directly accountable to Parliament

CANADA —The Governor is frequently asked to appear before Committees of both House of Commons and the Senate to explain and defend his policies. Other witnesses may be summoned to verify his evidence.

HUNGARY —The Governor is responsible to the Council of Ministers, to Parliament and to the Presidential Council of the People's Republic for the Bank's internal and external policies and may be examined by Parliamentary Committees. He is under no obligation to submit an Annual Report to Parliament.

JAPAN —The Governor can be and often is called to explain the conduct of monetary policy to the Diet. The Policy Board must also submit an annual report to the Diet, through the Minister of Finance - this must cover the financial condition of financial institutions, changes required in the law, changes in supervisory policy during the fiscal year and policies conducted and the reasons for their implementation.

SOUTH AFRICA —The Governor is accountable to Parliament and the Bank's annual report and financial accounts are tabled in Parliament. The governor is also examined by commissions of enquiry into financial matters appointed by the State President.

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	USA	—The Fed. Chairman is required to report twice a year to both Houses of Congress on the goals and conduct of monetary policy. In addition, both he and members of the Federal Reserve Board of Governors frequently testify before the Joint Economic Committee of Congress and other Congressional committees. From time to time the Chairman also sits on various government policy bodies. The Board as a whole meets with the Council of Economic Advisers at regular intervals; and Fed. staff also discuss policy problems with Administration staff at various levels. The Annual Report is published.
Countries where the Governor reports to Parliament largely for purposes of information	FINLAND	—Governor can be summoned to appear before Parliament only in a consultative or advisory capacity.
	ITALY	—Governor can be examined by Parliament for purposes of information.
Countries where the Governor is not examined by Parliament but is required to submit an annual report	AUSTRALIA	—Annual report and financial statement presented to both Houses of Parliament.
	DENMARK	—The annual report is published and presented to Parliament, although this is not a requirement.
	GERMANY	—The Bundesbank is independent of Parliament. It publishes an annual report.
	NEW ZEALAND	—Annual report submitted to Parliament but Governor not examined by Parliament. He is however subject to questioning by Treasury officials in private sessions of inter-governmental committee.
	NORWAY	—The Central Bank submits an annual report which is sent to Parliament and traditionally includes the Governor's broad views on the economy.
	SWEDEN	—An administration report is submitted to the Riksdag by the Board of the Bank.
	SWITZERLAND	—An annual report must be submitted to the Bundesrat.
	UK	—The Bank's Annual Report is laid before Parliament, but has never been debated. The Governor and other Bank members are examined on matters concerning the administration of the Bank by the Parliamentary Select Committee on Nationalised Industries and on financial and monetary policy by specially convened Committees of Enquiry. In general Parliament holds the Chancellor of the Exchequer responsible for the Bank's policies.
Countries where Minister of Finance is directly responsible for central bank's conduct of monetary policy	BELGIUM	—Minister of Finance, who has the right to control all the Bank's operations, is subject to examination by Parliament.
	FRANCE	—Bank's policy is examined, criticised and approved by Parliament through the Minister of the Economy. Exceptionally, the Governor may be questioned by Parliament. An annual report is submitted to the President of the Republic and its accounts are controlled by the Public Corporations' Audit Commission.
	NETHERLANDS	—Minister of Finance accountable to Parliament for Bank's enforcement of the Bank Act and measures taken under it. In addition bank must publish a weekly summary of its balance sheet and submit its annual accounts to its Supervisory Board.
	SPAIN	—Minister of Economy responsible to Parliament for the activities of the central bank. The published accounts have to be approved by the Minister.
Other	AUSTRIA	—The Bank is not accountable to Parliament in any way.

8. WHO OWNS THE STOCK OF THE CENTRAL BANK?

Countries where the stock is 100 per cent owned by the state	AUSTRALIA, CANADA, FRANCE, GERMANY, NETHERLANDS, NEW ZEALAND, NORWAY, SPAIN, UK.	
	DENMARK	—The Bank is an official government body, and no private body has a share in the General Capital Fund. Profits not allocated to the Reserve Fund or to special guarantee funds shall go to the Treasury.
	FINLAND	—No private body may own any share in the capital of the Bank. At least one third of profits to be transferred to the Reserve Fund; the remainder may be used according to the decision of the Diet, for public purposes.
	SWEDEN	—No private body may own a share in the capital of the Bank. Profits are at the disposal of the Riksdag—generally part goes into an exchange adjustment account and the remainder into the state budget.
Countries where the state holds only part of the stock	AUSTRIA	—Fifty per cent by Federal Republic; 50 per cent by persons and enterprises authorised by the federal government. Voting at General Assembly limited to minimum holding of 100 shares. Profits accruing are distributed to shareholders.
	BELGIUM	—Fifty per cent by the State; 50 per cent sold to the public—quoted on the Stock Exchange. General Meetings of shareholders can elect or dismiss Regents and Censors. Each share counts as one vote. Profits distributed proportionately to shareholders.
	JAPAN	-Fifty-five per cent government: 45 per cent privately owned, the private shareholders receive a small dividend but have no voting rights. Shareholders may transfer their holdings with the consent of the Bank, but the shares are not quoted on the Stock Exchange.
Countries where the stock is 100 per cent in the hands of the public	SOUTH AFRICA	--Votes limited to maximum individual stockholding of £10,000.
Other	ITALY	—Shares can only be held by "public law" banks, national interest banks, social security institutions, savings banks and insurance institutions. The government however holds a significant share in some of these institutions. Up to 20 per cent of net profits shall go to the Reserve Fund; of the remainder a dividend not exceeding six per cent of the capital shall be declared. Any excess to go into extraordinary reserves.
	SWITZERLAND	—The Confederation as such holds no shares. The shareholders are the cantons (38 per cent), cantonal banks (17 per cent), various other public bodies (three per cent), and over 5,000 private shareholders (42 per cent). The shares are listed on the Swiss Stock Exchange. Part of the profits shall be allocated to the Reserve Fund, of the remainder a dividend not exceeding six per cent of basic paid-up capital shall be declared.
	USA	—The Federal Reserve System is a federal government agency. The stock of the 12 Federal Reserve Banks is owned by commercial banks who are Federal Reserve members and are paid a dividend of six per cent, any remaining profits being paid into the US Treasury. Ownership of the stock, however, does not carry with it the usual attributes of control and financial interest.

Mr. **Turner**. Thank you, sir.

According to a recent survey supplied by the British-North American Committee, on which I serve, only Germany, among the major industrial countries, has a central bank which is "largely independent" of the national government in pursuing its duties, and even there the Bundesbank is obligated to support the national government's general economic policies. In countries such as Austria, France, Italy, New Zealand, Spain, Sweden, and the United Kingdom, the central bank is subject to the general direction of the government.

And in Belgium, Finland, Japan, the Netherlands, and Norway the central bank "must obtain specific government approval" for important policies.

Do we want to maintain that the United States really has benefited from the extreme independence of the Federal Reserve Board?

I could talk for an hour or two just about this very point, about this extreme independence of the Federal Reserve Board and the kind of damage it has wrought to our economy as of the present time.

President Reagan, himself, has said that once the Republican budget was adopted, interest rates should decline to 10 percent.

We agree, but he did not say a word, Mr. Chairman. I started to say a curse word there, Mr. Chairman.

Chairman **Annunzio**. It is permissible.

Mr. **Turner**. He did not say a damn word about telling that to the Federal Reserve Board, which he has the obligation and the authority to do, and we agree that it should be down to 10 percent and more. It should be down around 5 or 6.

What could do more to restore the credibility of our Federal Government than taking the bold action necessary to show it has the ability to restore the health of our economy?

The necessary action can begin with the adoption of the Low Interest Rate Act of 1982.

I recently was a participant in the midterm convention up in Philadelphia, and I must say to you, sir, that nothing was talked about more than the interest rate, on the grounds that that is the greatest hope for trying to fine-tune the economy and get America back to work.

I am so happy that you and Congressman St Germain, chairman of the full committee, have done what you have done and that your subcommittee is working on this matter, and we do hope something comes out, and we can get something moving.

[Mr. Turner's prepared statement, on behalf of the International Union of Operating Engineers and the National Council for Low Interest Rates, follows:]

TESTIMONY BY

J. C. TURNER, GENERAL PRESIDENT

INTERNATIONAL UNION OF OPERATING ENGINEERS

AND

CHAIRMAN,

NATIONAL COUNCIL FOR LOW INTEREST RATES

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE

U. S. HOUSE OF REPRESENTATIVES

JULY 14, 1982

Mr. Chairman, members of the Committee. My name is J. C. Turner. I am General President of the International Union of Operating Engineers, a union that represents more than 420,000 skilled workers. Most of our members operate heavy equipment in the construction industry.

I am also testifying on behalf of the National Council for Low Interest Rates, a broad-based coalition of organizations dedicated to achieving interest rates that are low enough to permit the economy to function properly and move toward full employment, to provide adequate credit for productive uses, and to allow American families reasonable access to home mortgages. The Council's members include the Consumer Federation of America, U. S. Conference of Mayors, the National Housing Conference, the National Association for the Advancement of Colored People, the Rural Electric Cooperative Association, the American Public Power Association, the United Auto Workers, the United Brotherhood of Carpenters and Joiners, the General Contractors of New York and the Industrial Union Department of the AFL-CIO, and of course, our union.

The purpose of my testimony is to urge the Committee to act quickly and favorably on H.R. 6124, the Low Interest Rate Act of 1982. The Act would extend the Credit Control Act of 1969 and amend it to give the President and the Federal Reserve Board the authority to combat recessions generated by excessively high interest rates. Further, the Act provides specific authority to restrict the use of credit for non-productive uses, such as corporate takeovers.

High interest rates are the quicksand of today's recession, relentlessly pulling under thousands of victims each day, from white and blue collar workers and farmers to small business people and yes, even larger corporations once believed to be immune from economic collapse.

Mr. Chairman, high interest rates are undercutting our ability to function as a society.

My union's industry, the construction industry, has been especially hard hit by the scourge of high interest rates. Unemployment among the skilled workers in the building trades has been running at a rate above 20 percent, more than double the national level. Even that figure, severe as it is, does not reflect the depth of the hardship being inflicted on construction workers in many parts of our nation. Among the members of my own union, [illegible] percent are unemployed in Yakima, Washington; 95 percent are without jobs in Dubuque, Iowa. In Milwaukee, seven out of our Operating Engineers are searching, in vain, for a place to apply their skills. In much of Massachusetts, the unemployment rate among our members is 77 percent. In Portland, Oregon, the figure is 61 percent, and in Rochester, New York, 85 percent.

I could continue this recitation of numbers across much of the land. But the point is that these figures translate into monumental suffering -- not only for Operating Engineers and their families, but for more than a million skilled Americans in the construction industry who want desparately to work but are being denied the opportunity.

Construction workers are not alone among those being cut down by the sword of high interest rates.

It is in recognition of this fact that unions welcomed the formation of the National Council for Low Interest Rates.

The Council membership is as diverse as the problem is great. We are concerned with every aspect of the multiple injuries being inflicted by high interest rates.

Small businesses, for example, are being forced into bankruptcy at a rate not equalled since 1933, at the depth of the Great Depression. They are being devoured by the inability to function under conditions in which as much as one dollar in every four is consumed by high interest rates. During the six months ended July 1, 1982 - 11,948 businesses failed. That's an increase of 30 percent over the 1981 failure rate, and equal to the number of business bankruptcies recorded during the full year of 1980.

Each of those bankruptcies represents a multiple loss of jobs, and a further weakening of our general economy.

For businesses, and particulary small businesses, high interest rates have taken on a self sustaining quality. Many of those who operate businesses are being forced to borrow money in order to pay the interest on their old loans. This practice represents a Catch 22 that can lead only to failure.

Many of the members of this Committee are fully aware of the desperation that high interest rates is sowing among our country's farmers. Thousands have been placed in the position where they can no longer borrow the money they must have to prepare their fields and plant their crops. All that remains for these victims is a slow economic collapse.

Mr. Chairman, it is difficult to overstate the tragic cost being extracted from our farmers by high interest rates. The outstanding debt of farmers in 1981 rose by 15 billion dollars to a staggering $195 billion dollars. Farmers paid out more to service this mountain of debt than they received in net income.

While farm debt has been soaring, farm asssets have become frozen at a trillion dollars. Indeed, the market value of farm land -- the basic collateral for loans -- dropped by a full percent between February of 1981 until April of this year.

These catastrophic circumstances are placing more and more of our farmers in a vise from which their only escape is liquidation and bankruptcy.

The plight of our housing industry, which has become the heartbreak of untold numbers of Americans wanting to fulfill their dream of becoming homeowners, is being reported on a regular basis. New housing starts in May, were still stumbling along at an annual rate of just 1.1 million.

Houses are not being built because they cannot be sold. They cannot be sold because of the outrageous mortgage interest rates, which exceed 17 percent. To put that figure in perspective, the cost of interest payments alone on a 17 percent mortgage will equal the amount being borrowed in less than five years.

Not only has this brought severe unemployment in the housing industry, it has savaged many directly related industries, including lumber, concrete and the entire real estate sales sector.

Another economic sink hole created by the quicksand of high interest rates is the auto industry. Others will testify in detail to the wholesale casualties suffered by our once dynamic, profitable and proud American auto industry. But for the record here, let it be noted that car sales, both domestic and foreign, during the first six months of this year were 10 percent below the depressed rate of a year ago. Sales last month were the lowest for any June in a quarter of a century.

Since the industry's last "normal" year -- 1978 -- domestic automobile production has tumbled 35 percent; truck production has dropped by 50 percent.

Again, buyers are stymied by the high interest rates demanded to finance the purchase of a new vehicle.

And again, workers are among the primary casualties. A quarter-million jobs have vanished from auto production plants, and three times as many from companies who supply the auto manufacturers.

Utilities, and particularly our electric utilities, are our economy's most capital intensive industry. Each dollar of annual revenue requires an investment of three to four dollars. Electric utilities alone require 15-to-20 billion dollars in new money each year.

High interest rates have not only disrupted the electric utilities financial market, they have imposed a heavy cost burden on consumers.

Nor is government, itself, exempt from the debilitating drain caused by high interest rates.

Government at all levels must pay the high interest rate penalty that our current economic policy is extracting.

The fastest growing item in the Federal budget is interest payments. This fiscal year alone, taxpayers will be forced to underwrite 115 billion dollars in interest payments -- an amount that may equal our Federal deficit. Next year, the Treasury tells us we can look forward to paying 132 billion dollars for interest, an amount more than sufficient to cover all of the painful cuts that have been made in programs serving our society's well being.

The interest being paid on the public debt has far outstripped the growth in the debt itself. Since 1954, the public debt has more than tripled, but the interest payments made to finance that debt have multiplied 12 times.

State and local governments have been afflicted by the toll of interest payments, as well. Interest costs for the average state and local security have doubled in their dollar amounts in the past five years.

Mr. Chairman, this is far from a complete list of the segments of American society that have been wounded by interest rates that are clearly out of control. From the steel industry to the little person who must borrow a few dollars quickly to meet an emergency, high interest rates have become a ransom demanded by our wrongheaded economic policy -- a ransom that is becoming increasingly beyond the ability of many to pay.

In order to bring down interest rates and maintain rates compatible with healthy economic growth, we strongly support Chairman St Germain's bill, H.R.6124, the "Low Interest Rate Act of 1982." Chairman St Germain's bill, along with its Senate companion introduced by Senator Alan Cranston, S.2526, extends and improves the Credit Control Act of 1969. We are convinced that use of the Credit Control Act offers the only avenue available for removing the crushing burden of high and volatile interest rates.

The Low Interest Rate Act extends the ability of the President to authorize the Federal Reserve Board to control credit. It improves the "trigger" for the use of that authority by including considerations of recession and unemployment -- the current products of our nation's monetary policy -- in addition to the original consideration of the Act for preventing or controlling inflation. There can be no doubt that these additional triggering criteria are appropriate in today's climate.

The St Germain bill further improves on the 1969 Act by explicitly authorizing the Federal Reserve Board to "ensure the availability of credit for productive and necessary purposes," specifically by prescribing "limitations with respect to credit for nonproductive purposes, including corporate takeovers."

Our coalition is deeply committed to each of these provisions of H.R.6124.

First, our Nation's one experience with credit controls under the 1969 Act -- for a brief period in the spring of 1980 -- indicates that they can work to bring interest rates down dramatically: in a matter of weeks after the imposition of controls the prime interest rate fell from 20 percent to 12 percent, and the decline in home construction and overall economic activity was actually reversed. I think we also learned some lessons from that experience about how not to apply selective credit regulations, particualarly in squeezing out consumer credit on what became in some cases a retroactive basis.

Foreign experience also indicates that selective credit measures can and do play a vital and successful role in helping maintain healthy economic growth consistent with holding the line on inflation. The Japanese financial system has for years functioned on the basis of "administered" interest rates, with targeting of capital flows to priority industrial developments. The Japanese results have certainly been successful, with low inflation and unemployment coupled with strong productivity growth and industrial investment, and an exchange rate (largely caused by the gap between Japan's low interest rates and record high interest rates in other industrial countries) conducive to strong international competitiveness. The converse example is provided by Great Britain which, under Margaret Thatcher's Conservative government, has pursued a monetarist policy similar to that of our own Federal Reserve Board. The results in Britain have been similar to those in the United States: recession and high unemployment coupled with falling industrial investment and, subsequently, falling productivity. Their international competitiveness, like ours, has suffered from the undermining of new investment by high interest rates and by the overvaluation of their currency stemming in large part from their very high interest rates.

The members of our coalition, as we mentioned earlier, are convinced that there is no practical alternative to selective credit controls as a means of lowering interest rates. Lowering interest rates and maintaining them at reasonable levels are in turn necessary for economic recovery from what has become the deepest recession since the 1930s -- a recession caused and now perpetuated by high interest rates.

The present economic conditions in this country and the persistence of very high interest rates -- and record "real" interest rates --are far from normal. It is precisely the *abnormal* nature of our present circumstances that make credit controls necessary for bringing rates down and holding them down. First, our country is experiencing a record boom of corporate mergers which are soaking up unprecedented tens of billions of dollars of loan capital without adding one whit to the productive capability of this country. This record demand for credit for nonproductive corporate takeovers is directly limiting the availability of credit for other, productive uses and driving up interest rates for everyone. Second, our nation's economy is locked on track with a more or less fixed combination of fiscal and (unless changed) monetary policies which will keep interest rates destructively high and volatile for the next year at least -- unless relief is provided through the channel of credit controls.

On corporate mergers and their impact on the demand for credit, our coalition published just last month a study by Stephen Brobeck, executive director of the Consumer Federation of America and a member of the steering committee of the Low Interest Rate Council. Our report, "The Merger Boom and High Interest Rates," summarizes the impact on credit markets of the current wave of corporate takeovers and the massive use of loan capital and lines of credit to finance those mergers. By 1981 merger activity had reached an all time high, rising from $11.8 billion in 1975 to $44.3 billion in 1980 and finally to $82.6 billion in 1981. Lines of credit held open in our Nation's banks to finance planned mergers by these blue chip corporate borrowers tied up an estimated $70 billion. The estimated $34 billion in merger-related bank loans exceeded all new loans to farms and all new loans to state and local governments in that year.

These merger loans and lines of credit for these nonproductive investments squeeze out productive users of credit such as industry, housing, farmers, utilities, and state and local government. Why, we ask, should corporations like U.S. Steel, Dupont, Mobil and Fluor tie up money that could better have gone for industrial investment or home mortgage loans? "Tilting" available credit away from nonproductive uses and toward productive investments will have the effect of increasing the available supply of capital and lowering interest rates for productive uses of credit.

Basically there seems to be no viable alternative to selective credit regulation as a means of lowering and stabilizing interest rates in the existing environment of fiscal policy. The credit markets, according to many observers, seem to believe that tight controls on the growth of the money supply is necessary. If Wall Street perceives that the money supply is growing too rapidly, it is said, then interest rates will go up in the expectation of increased inflation in the future; conversely, if the Federal Reserve Board were to tighten down further on the growth rate of the money supply, interest rates would also be driven up by limited supply. Moreover, the framework of fiscal policy is more or less fixed for the next year through the Congressional budget process. Present estimates show the Treasury issuing between $85 billion and $120 billion of new debt during the second half of this year --a demand for credit incompatible with economic recovery and with unlimited credit demands for unproductive corporate mergers. While the projected federal deficit of $100 billion or more is considered by many to be irresponsibly expansionary, we note that each one percent of unemployment adds some $27 billion to that federal deficit, and that a four perent reduction of unemployment -- from 9.5 percent of the workforce to 5.5 percent --would produce a federal budget surplus of several billion dollars. At 4.5 percent unemployment the present budget would be producing a surplus of more than $30 billion.

Whether one "likes" them or not, the macroeconomic parameters are basically fixed. Yet we find continuation of this punishing, irrational recession intolerable. The one alternative we see -- and the one support -- is the tilting of available credit toward needed productive uses, as provided in H.R.6124.

For those who would decry any loss of independence of the Federal Reserve Board through such an invocation of credit controls, I would like to point out that ours is the only major industrial nation which allows such total and extreme independence to its monetary authorities. According to a recent survey prepared by the British-North American Committee, on which I serve, only Germany among the major industrial countries has a central bank which is "largely independent" of the national government in pursuing its duties, and even there the Bundesbank is obligated to support the national government's general economic policies. In countries such as Austria, France, Italy, New Zealand, Spain, Sweden and the United Kingdom the central bank is subject to the general direction of the government. And in Belgium, Finland, Japan, the Netherlands and Norway the central bank "must obtain specific government approval" for important policies. Do we want to maintain that the United States really has benefited from the extreme independence of the Federal Reserve Board?

Mr. Chairman, the call for lowering interest rates is a nearly universal one. Much of the business community, all of organized labor, farmers, the savings and loan industry, representatives of minorities and the poor -- all are beseeching the government to bring interest rates down and place them under control.

Even our friends abroad are looking to us to stabilize our own economy by reigning in interest rates, an action that in turn will help them to settle their economic turmoil.

President Reagan himself has said that once the Republican budget was adopted, interest rates should decline to ten percent. We agree.

What could do more to restore the credibility of our Federal government than taking the bold action necessary to show it has the ability to restore the health of our economy?

The necessary action can begin with the adoption of the Low Interest Rate Act of 1982.

Chairman **Annunzio**. Thank you, Mr. Turner, for a very excellent, practical, and informative statement. We have a vote on the floor of the House.

I am going to ask the panel to remain.

The members will be back, and we have some questions that we would like to ask.

We will be back immediately after the vote.

[Brief recess.]

Chairman **Annunzio**. The meeting of the subcommittee will come to order.

Mr. Sheehan, could credit controls be used to bring down interest rates sufficiently to reverse the type of lending that has swept over the savings and loan associations?

Mr. **Sheehan**. Mr. Chairman, our experience in 1980, when the credit controls were put into effect for 3 or 4 months, was that interest rates did come down. It helped the savings business considerably, because our cost of money went down and naturally it helped the homebuilder and the labor people, because things came up for 3 or 4 months, for that small period of time.

Chairman **Annunzio**. I know you have expressed yourself on this before, but in the recession under Carter, when he did use credit controls, as you mentioned, interest rates did come down, and this is exactly what all of us are striving to do; so, in your opinion, if you were advising the President of the United States, because there is nothing mandatory about this policy—you don't look a gifthorse in the mouth—how would you advise the President, as far as this legislation?

Let us be practical here this afternoon. The administration is against it. This bill will pass this subcommittee. We have enough votes on our side, and I think the chairman would agree with that statement I think on our side, to pass it in subcommittee, but we are going to have a big job in the full committee.

We are all going to work hard for it. How would you advise the President?

Mr. **Sheehan**. Well, Mr. Chairman, I certainly would advise him at the appropriate time to enforce or to put into effect his powers in order to, as Mr. St Germain's original bill states, to prevent recession, to help employment, and to control interest rates, three different things you are trying to do in your bill.

The only criticism that I was conscious of with the 1980 Credit Control Act, was that there was apparently a congressional study made, saying that it was not effective. But they did say in this particular study and I am quoting from it:

> A retracing of the events leading to the imposition of the Credit Control Act 2 years ago strongly suggests that the Presidential powers delegated to the Federal Reserve were conferred in haste and without appropriate congressional hearings as to the potential impact on the economy.

So it would seem to me, if I were the President, I would want to invoke them, but then I would have the Federal Reserve or whomever has the power, to come back to Congress and say, hey, this is what we are going to do that would give the Congress a chance to see what the regulators are going to do. This would give the President sufficient protection and give you Congressmen a hand in it and save all the problems that Mr. Carter had.

Chairman **Annunzio**. Thank you.

I note that two more subcommittee members are here. I would like a member of my staff to keep time. I don't want any more than 5 minutes to ask questions, and I want each member to have 5 minutes to ask questions, and then if they have additional questions, we will go back. Whenever my 5 minutes are up, let me know.

Mr. Sheehan, the Fed has put much emphasis on monetary policy. Do you believe that this single minded emphasis has succeeded in keeping the recession from becoming worse, or is it part of the problem?

Mr. **Sheehan**. Well, I would say, in my opinion, Chairman Annunzio, it is part of the problem.

I feel personally that there is no good reason for these high interest rates to be existing today.

I am inclined to blame this on the big bankers. I see no reason when they have about a 5 or 6 percent spread of the cost of their money and the cost of the prime, that they have to keep these high interest rates on, and it is the consumer who is paying the burden: the labor man, the homeowner, and the farmer here.

They are going to their local banks and trying to get money, and the banks are demanding 16 to 21 percent.

Part of it is the big banks, and part of it is the money market funds. Why?

The guy in Podunk, Iowa, and the guy in a small city in Illinois, he wants to put his money into the money market funds, because he is getting 13 or 14 percent.

The greatest part of the money market funds goes to the big banks. The big banks are giving it to the people who can afford to pay 20 or 21 percent.

We can't afford it in the savings and loan business. We traditionally work on a spread of 1¼ to 1½ percent. I see no reason why the big banks need a 5- to 6-percent spread.

Continental Illinois Bank loses $100 million. With the Drysdale, securities scandal the big banks lose $1 billion. Who is paying for that but the smaller people who are getting high interest rates, because it goes to the big guys? This is an opinion I particularly have.

Chairman **Annunzio**. I hope you are happy in the savings and loan business, because you are thinking just like I do; you would make one hell of an opponent in the 11th District.

Mr. **Sheehan**. Frank, you know my high regard for you for many, many years, as a Republican and as the guy who was the leader of the Reagan political campaign in Illinois, and we came up with 400,000 majority for them when nobody else thought—I still feel that you do a great job in our district.

Chairman **Annunzio**. I am sure happy to hear that.

Mr. Paul?

Mr. **Paul**. Thank you, Mr. Chairman.

I first would like to ask unanimous consent to submit a letter from Mr. Richard Pratt of the Federal Home Loan Bank Board for the record.

Chairman **Annunzio**. Without objection.

[The letter follows:]

Federal Home Loan Bank Board

RICHARD T. PRATT
CHAIRMAN

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

JUL 1 4 1982

Honorable William J. Stanton
Committee on Banking, Finance
and Urban Affairs
House of Representatives
Washington, D. C. 20515

JUL 14 1982

Dear Mr. Stanton:

This is in response to your request for our comments on H.R. 6124, a bill that would provide authority under the Credit Control Act of 1969 (the "Act") on a permanent basis. The authority for the Act expired June 30, 1982. H.R. 6124 would also broaden the "triggering" mechanism in the current law to authorize the Federal Reserve Board to regulate and control any or all extensions of credit whenever the President determined it was necessary to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession. The Act now refers to use of its special powers in controlling inflationary uses of credit.

The specific measures that the Federal Reserve might take under the Act are virtually all-inclusive. For instance, it could require licensing or registration of transactions and provide for limitations on such licenses; prescribe record-keeping requirements; specify or limit the terms and conditions for extensions of credit, including interest rates, amount of credit extended, and maturity; specify limits on ratios of loans to deposits or assets; or even prohibit any extension of credit. Finally, H.R. 6124 would add a new power to those previously exercised by the Federal Reserve Board under the Credit Control Act, in that it would permit the FRB to prescribe limitations "with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes."

As a general matter, I believe that free markets are the most efficient allocators of economic resources. Experience, other than in wartime, with economic controls such as those envisioned under the Credit Control Act has been highly problematical. Additionally, while having such stringent controls available on a stand-by basis for use in times of economic emergency might be helpful, I am confident that Congress would respond rapidly to address evolving circumstances should it appear that mandatory controls were in the public interest. The House of Representatives has demonstrated such responsiveness several times over the last year in responding to the very volatile conditions in the financial community by acting very quickly to pass a resolution affirming that the full faith and credit of the United States stands behind the federal deposit insurance agencies, to pass legislation which would provide temporary net worth support for the savings and loan industry, and to pass certain extraordinary powers for the regulators under the so-called "Regulators' Bill."

I hope this response has adequately addressed your concerns. Please note that in accordance with 12 U.S.C. § 250, this letter has not been reviewed outside the Federal Home Loan Bank Board and does not necessarily represent the views of the President.

Sincerely,
Richard T. Pratt
Chairman

Mr. **Paul**. I would like to make a general statement and apologize to the chairman, because I need to leave shortly to go to the House floor, but, I, too, like everybody else, am concerned about high interest rates. I have not met anybody in the Fed or in the administration, or on the House floor that is for high interest rates.

I think there is a bit of confusion, though, when you see an economist, one that I highly respect, come up with a statement like Milton Friedman did, saying that he really does not quite understand why interest rates are high. Because I disagree with him on monetary policy, I can see why he makes a statement like that.

But I think the most important point that I would like to make, the one point everybody fails to see—and I happen to believe very firmly until we address this subject, interest rates are going to go higher and get worse—whether you have credit controls or not, we will see interest rates of 30, 40, and 50 percent, as we have seen in many other nations of the world.

Even though we have spent many decades with discretionary monetary policy, we have moved into an age in the last couple of years in which we have adopted a policy of monetarism, where the Fed have concentrated on the supply of money and not interest rates, and yet we have not seen any good results.

The main thing the Fed has failed to address is the subject of quality of money. You can control the quantity of money, and that is important, but the quality and integrity of the money are important, too.

For this reason, until we have a money that we can trust, until we deal with the trust factor and the risk factor, you will never get anywhere in trying to understand interest rates by saying real interest rates ought to be 3 or 4 percent, and the inflation any premium ought to be 3 or 5 percent, and, therefore, you should have interest rates no higher than 10 percent.

When you deal with interest rates, you totally understand why interest rates could be 16, 18 or 25 percent. Regardless of how fast prices go up, and until we have a real currency, I think we will be in this dilemma, and things will get much worse. The specific question I have for the panel, and, in particular, Mr. Sheehan, is: How can you accept the idea of giving additional power to the Fed?

The Fed is going to operate these controls. The chairman isn't going to do it; the Congress isn't going to do it. We abdicated our responsibilities by giving this to the Fed, even though we have the responsibility to do something about the money and interest rates.

We have a strong coalition in the Congress right now, demanding and insisting, for once, that we open up the books of the Fed and see how it operates.

Instead of not opening up the books of the Fed and finding out what is happening, we give them more power. They might allocate credit exactly the opposite of what you want. They might decide to give more credit to the larger corporations than they are getting now, and make the situation much worse.

I wish we could amend this instead of saying give more power to the Fed and allowing them to do more to us; we ought to consider auditing the Fed and know exactly how the system operates. How, under these circumstances, can we stand the idea of giving the Fed more power instead of thinking about giving them less, since you are not pleased with the Fed?

Mr. SHEEHAN. I did state before that a study was made, and I don't know who made it. I have the study here, but it did say in order to put this thing in the record, contact Godfrey Briefs or Gregg Wilson for more information.

They apparently wrote a report on the effect of the 1980, under the Carter administration, putting the credit controls on. In their statement they said, and I firmly believe in this, because in my years of Congress here, I know we were always griping and hollering about the regulators.

Chairman ANNUNZIO. For the benefit of Mr. Sheehan, Godfrey and the others were three minority staff members, members of the Republican Party, who wrote that.

Mr. SHEEHAN. Then I would say this, Mr. Congressman, it is more appropriate, because they pointed out that if the Fed, before putting this thing on and making a decision, were to come back to Congress, and tell you what they were going to do, this would give the President protection.

Chairman ANNUNZIO. That is absolutely correct.

Mr. PAUL. Are they going to be obligated to do that?

Mr. SHEEHAN. I would like to see them obligated. Before they obligate, the Congressmen would have a chance to see it and look at it. They write a law, and it goes to the regulators, and they interpret it differently.

Mr. PAUL. I can't understand your unfailing trust in the system. You are trusting the Fed to do what you are asking them to do.

Mr. SHEEHAN. I am trying to say they ought to come back and report to you fellows and get the congressional OK without doing it blindly.

Mr. PAUL. You have admitted that does not happen. We turn it over to the regulators. We have not touched the money system since 1913, and look at what we have had, total chaos, and now virtually the destruction of the dollar. Now, we want to give more power to the Fed? It seems inconsistent.

Mr. SHEEHAN. I think offhand the Congress ought to maintain or keep some of the power so the regulators come back and don't interpret what they want to interpret into the law. Too frequently the regulators are supposed to go through the hearings and pick up what Congress meant. They just interpret it the way they want.

Mr. PAUL. I can support that improvement.

Thank you.

Chairman ANNUNZIO. Your 5 minutes are up.

Mr. St Germain?

Mr. ST GERMAIN. You say you would support that improvement, but that would not lead you to support the legislation?

Mr. PAUL. Not the legislation, but I would certainly support seeing that Congress takes more responsibility over the Fed and not, you know, give more power to the Fed.

Mr. ST GERMAIN. I just want to express my appreciation to the panel. You have made your points, and your written submissions are excellent, and there is no way that I can embellish upon it. I am most appreciative of your collective support. That is what we are looking for, is support, but we are also looking for that which you provide, Senator Miner, the grassroots testimony of what is actually happening out there around the country.

I think we have to be responsive to that. When you look at the numbers that you cited to us, how in God's name can those people survive? They can't. They can't.

Mr. Turner represents labor; we have had many hours together, discussing this legislation. We discussed its importance not only to the members of the labor movement that you represent, but to the many people out there who are the small business people and the consumers, the potential homeowners.

Mr. Davis, it is a pleasure to have you testify. There is no doubt of the fact that, believe it or not, Wall Street is affected here, and very, very adversely, because of the unrealistic interest rates that prevail.

Why would a businessman want to risk capital in expanding his business when he can put the money into a jumbo CD or high-paying money market funds and with no risk, get a guaranteed return on his money? So we are stifling the American enterprises, very definitely.

Mr. Sheehan, I want to compliment the United States League on bringing us a very excellent witness, and we appreciate your assistance, your testimony, and your support.

Thank you, Mr. Chairman.

Chairman ANNUNZIO. Thank you, Mr. Chairman.

I have two more questions, really three, so that I can get your responses on the record.

Senator Miner, can today's farmers successfully compete with Mobil and Texaco for credit in a free market?

Mrs. MINER. It doesn't look like it, does it?

Chairman ANNUNZIO. Mr. Turner, you cited in your testimony the devastating effect that high interest rates have had among farmers, construction workers, auto workers. Is there any industry that has not been affected by high interest rates?

Mr. TURNER. I do not know of any which have not been adversely affected by high interest rates.

Chairman ANNUNZIO. High interest rates—do you agree with this statement—have permeated every facet of life of every human being in this country? Would you agree with that?

Mr. TURNER. I certainly would. It has completely crippled our society.

Chairman ANNUNZIO. Mr. Davis, you point out in your testimony that we are at a time of paradox—expensive, easy money, and you put part of the blame on banking deregulation, which is up my alley. I did not sign that deregulation conference report. I was the only member. Is the phasing-out of regulation Q providing the deposit interest ceilings partly to blame for this phenomenon?

Mr. DAVIS. Absolutely. Historically, banks were limited by regulation Q on what they could pay, and if prices rose, if you had a boom in business, inflation, the interest rates would go up to that rate, and then the banks could not attract money at that rate, and people would say, well, the banks won't pay me more than 5 percent; I will go out and put my money into government, equities, corporate bonds, long-term, and that made long-term credit unavailable.

Now, we have the reverse of that. We have reversed the competition from the banks' desire to make loans competitively to the banks' desire to pay the most so they can attract the funds, because they know they can pass on that higher cost to the borrower, and so it has become a destructive upward cycle and the benefit of disintermediation has disappeared completely.

You have no access to money by even the best corporations—no access to long-term equity by any corporations. It pushes everybody back into the need, the desperate need, for short-term funds at these high rates.

That is the only market available to them, and so if you wanted a design, Mr. Chairman, a system, an approach to destroy the capitalistic system, you could not design one better than we put together here in our economy today; and to say that the Fed has been ineffective is absolutely true, but this administration and the people elected here have a responsibility to make things happen, not to do surveys or to question Treasury Secretary Regan or President Reagan. Theirs is not to predict; they are to make things happen. They have to take actions, for better or worse—better anything than what we have now—so I urge that this subcommittee move aggressively ahead, and I pray that they are successful.

Chairman ANNUNZIO. Thank you, Mr. Davis. Your answer has heartened me, having been the only member of the committee that did not sign that conference report. You have convinced me now that I was right. That is the way I feel.

I want to thank each and every one of you for your constructive contribution to the legislation. I am sure that, as the subcommittee reads the record and we further deliberate this legislation, that your statements and your answers to questions will help us reach a final determination.

I am very seldom wrong on my subcommittee, but I want to say to you that as far as this subcommittee is concerned, I feel we are going to pass the Credit Control Act. I am not responsible, but I will work like hell on the full committee, so I state my position in advance to those who will appear tomorrow and the next day against this legislation.

I want my position clearly understood. I favored credit controls back in 1980, and I favored the standby authority that we gave President Nixon. I made that a major campaign issue in 1972, the rollback, wages and prices, and some of my good pals in the labor movement were not always for the program, but are for the program provided it is an all-inclusive program. They want it across-the-board. That is a very difficult program to sell, but it did save.

Standby controls saved what was left of the Nixon administration at that time. Standby controls saved the Carter administration, and I want to tell you this administration needs something if it is going to live, and I think this is a vehicle that they need. I know the American people need it, but they need it for their administration, because, when we talk about 9.1 million out of work, we are not talking about those that are indirectly affected.

You come to my city of Chicago, and we have pockets of unemployment where 25 percent of the population is unemployed.

This thing cannot exist. This situation cannot exist in a free society if that society is to remain free; so I thank each and every one of you for your appearance here this morning.

The next panel is Ruth Kobell, legislative assistant of the National Farmers Union; Mr. Henry Schechter, director, Office of Housing and Monetary Policy of the AFL-CIO; Mr. Sheldon Friedman, research director of the United Auto Workers; and Mr. David Stahl, executive vice president of the National Association of Home Builders.

You all have prepared statements, which I have before me; so I will ask unanimous consent that your entire statements be made part of the record, and, without objection, they will be made part of the record.

I ask that you proceed in your own manner for 5 minutes or so, and then if there are any other members of the panel present, we will have questions. I have talked with the subcommittee members, and some of you will be getting questions from them, and I am keeping the record open for some reasonable time. The time is limited. I don't want to announce a couple of weeks and then we will close it, because I wish to get to markup of this legislation.

Our first witness today is Ruth Kobell, legislative assistant of the National Farmers Union.

STATEMENT OF RUTH E. KOBELL, LEGISLATIVE ASSISTANT, NATIONAL FARMERS UNION

Ms. KOBELL. We appreciate the opportunity to be here. I have with me today Mr. Hal Long from Garber, Okla., who is a John Deere implement dealer along with his father, brother, and his son, and I have felt it would be much more appropriate for him to talk to us about what interest rates have meant to the small businessman in rural America, and I would ask that my time be used by Mr. Long in his presentation.

[Ms. Kobell's prepared statement on behalf of the National Farmers Union follows. Also submitted was a publication of the

National Farmers Union "Depression in Rural America," available from the Department of Field Services, National Farmers Union, Denver Colo. 80251.]

National
Farmers Union

STATEMENT OF

RUTH E. KOBELL
LEGISLATIVE ASSISTANT
NATIONAL FARMERS UNION

PRESENTED TO

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE
OF THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

WASHINGTON, D.C.
JULY 14, 1982

The Wall Street Journal recently quoted a Republican member of the U.S. House of Representatives as believing that "practically speaking there isn't much that can be done" to bring interest rates down.

Almost everyone in the nation agrees that lower interest rates are the key to economic recovery, to new life in the housing and auto industries, to improved net income on the farm and to increased consumer purchasing power.

It does not matter much whether such defeatism about reducing interest rate levels is a sincerely held belief, a pretense or a cop-out. The net effect is dangerous and damaging because it tends to ignore or obscure the most direct route to lower interest rates.

There is, after all, nothing impossible about bringing interest rates down, if there is any will to do so.

Interest rates are high, not because of market factors, or divine ordinance, but because the White House and the Federal Reserve Board of Governors want them high.

Interest rates will stay at devastatingly high levels as long as Administration policy-makers and the "FED" want them there.

In the Farmers Union, we are not much impressed with the rhetoric which suggests that interest rates are high because the federal budget is "out of control."

There is no demonstrable evidence of a connection between federal deficits and interest rates, or for that matter between federal deficits and inflation.

Since 1929, there have been 47 years in which the federal budget was "in the red" but in only 16 of those years has the inflation rate exceeded 5% and in only ten of those years has the prime rate of interest exceeded 6%.

The claimed relationship between federal deficits and high interest rates is suspect, in our opinion, because federal debt is only about 14% of the total public and private debt load of more than $7 trillion.

The federal debt is dwarfed by the private borrowings of $5.7 trillion.

True, federal debt has more than doubled since 1975 (and since last October 23, has exceeded a trillion dollars), but private debt has roughly tripled in the same period.

All of the attention now seems to be fixed upon the volume of borrowing which the U.S. Treasury Department will be doing in coming weeks and months, while little is said of the massive corporate refinancing which will be taking place.

Certainly, not enough is said of the wasteful diversion of $60 to $70 billion a year in the financing of corporate takeovers, which serve no apparent useful purpose for society.

Earlier, we stated that interest rates can be held at reasonable levels if there is a will to do so. It is useful to remember that while the current policy-makers cannot seem to find the key to lowering the present 16½% prime rate, it was both possible and feasible for the Franklin D. Roosevelt and Harry Truman Administrations to hold the prime rate continuously at or below 3% for more than twenty years, a time span which included war, depression and other difficulties.

As a matter of fact, for 13 years from April 1934 to September 1947, the prime rate was continuously held to 1% or less. (See ATTACHMENT "A".)

We indicated at the opening that the most direct route to lower interest rates was being ignored.

That is to direct the Federal Reserve Board either by legislative or executive order to lower interest rates or otherwise control the extension and terms of credit.

Authority exists in broad and general terms under Public Law 95-523, the "Full Employment and Balanced Growth Act of 1978."

Through June 30, 1982, more specific authority existed under Public Law 91-151, the Emergency Credit Control Act of 1969, under which the President could direct the Federal Reserve Banking system to take certain actions to limit and regulate the extension of credit, set interest rates and repayment terms, and to allocate credit to productive uses.

The Emergency Credit Control Act of 1969 was only implemented once, by President Carter in 1980, and then abandoned within about two months, without having utilized the credit allocation authority.

In several instances, in presenting testimony to the committees of Congress on the credit situation and high interest rates, National Farmers Union recommended the extension and use of the powers under the 1969 Act. (See ATTACHMENT "B".)

We regard the House bill, H.R. 6214, as very desirable since it not only extends the life of the 1969 Act, but also provides authority for the limitation of the use of credit for nonproductive purposes such as corporate take-overs. Similarly, the Senate bill, S. 2526, deserves early consideration.

We are aware that the White House does not want this legislation and may not use the authority if the bills become law.

One other alternative is still available, in that the Congress could by direct legislation order a specified roll-back of interest rates.

The board of directors of the National Farmers Union, meeting in May of this year, in Washington, D.C., recommended legislation which would mandate a roll-back of interest rates by at least 2% each calendar quarter for the next year. The practical effect would be to reduce the prime rate from the current 16½% rate to about 8% in a year's time.

Our Board made this recommendation, recognizing that reducing the federal budget deficit to the neighborhood of $100 billion or of making verbal suggestions to the Federal Reserve to reconsider its money supply targets, are largely cosmetic approaches unlikely to have any desired immediate effect.

On the other hand, believing that the reduction in interest rates is imperative and must be the initial and primary objective, our Board proposed the "rachetting down" of interest rates by at least 2% each calendar quarter beginning October 1, 1982.

Such a roll-back of interest rates by at least 8 points in fiscal 1983, would not only be a god-send to consumers and to the basic industries such as agriculture, housing and automobiles, but also would assure major savings in the federal budget itself.

Gross interest outlays on the federal debt are now likely to be $133 billion in fiscal 1983, rising to more than $200 billion by 1987. Over the five-year period, failure to reduce interest rates to tolerable levels will add more than $600 billion to the federal deficits.

One may not prefer the stern medicine of credit controls and credit allocation, but they are clearly more acceptable than the intolerable alternatives of harsh inflation, recession, high unemployment and hardship.

We believe that the time is here for a direct attack upon the interest rate problem. The interest rate reduction will have to come first if there is to be a sustainable economic recovery.

ATTACHMENT "A"

PRIME INTEREST RATE, SELECTED YEARS
1933 - 1953

1933	1.73
1934	1.02
1935	.75
1936	.75
1937	.94
1938	.81
1939	.59
1940	.56
1941	.53
1942	.66
1943	.69
1944	.73
1945	.75
1946	.81
1947	1.03
1948	1.44
1949	1.49
1950	1.45
1951	2.16
1952	2.33
1953	2.52

ATTACHMENT "B"

1982
Policy
of
National Farmers Union

Adopted by Delegates to
the 80th Annual Convention

Washington, D. C.

February 26-March 2, 1982

ARTICLE II
CREDIT PROGRAMS FOR THE FAMILY FARM

As of January 1, 1982, United States farmers had outstanding debts of about $200 billion. Interest outlays in 1981 were about $20 billion, which means that farmers had $10 of debt outstanding for each dollar of net income. By comparison, in 1975 farmers had $3.33 of debt for each dollar of net income.

By other measurements, such as the debt to asset ratio and the debt to equity ratio, the present situation is the most unfavorable in 40 years.

If farmers are to sustain needed production, borrowing is not a discretionary thing. Farmers have had to substitute credit for income to an alarming degree. In 1970, American farmers depended upon borrowing for only 5.2 percent of their cash sources of funds. By 1980, the dependence on borrowing had risen to 20 percent and, in 1981, to 23 percent.

The situation in 1981 was one in which farmers had to borrow more and pay higher interest rates, while sagging income sharply reduced their ability to repay the loans.

This has put many farmers in a precarious position, facing liquidation or foreclosure. To enable them to continue in production in 1982, we propose additional emergency lending as needed, together with a one-year moratorium on principal and interest payments due to the Farmers Home Administration (FmHA).

Farm credit is not a substitute for parity farm prices and income.

Access to adequate credit at reasonable cost is essential if family farmers are to operate effectively and competitively. Government policies and programs should be designed to assure an adequate flow of credit to independent farmers.

We deplore the constant escalation of interest rates which imposes an intolerable burden, especially upon beginning farmers. It is absolutely necessary for the survival of family farm agriculture that we return to long term fixed interest rates not to exceed 8 percent.

D. Money and Credit Policy

Farmers are drastically injured by the current high interest rates being employed, without success, to dampen inflation.

A better remedy is available in the form of the emergency powers conferred on the President by the Emergency Credit Control Act of 1969, under which the President may limit credit use, may prescribe interest rates and credit terms and, if needed, may allocate credit to productive uses. Severe as such actions would be, they are preferable to continuing the present totally ineffective policies.

The Federal Reserve Banking Board should be compelled to conform its policies to the goals of the "Full Employment and Balanced Growth Act of 1978", and it should be made accountable to the U. S. Congress for policy-making activities. Federal Reserve statutes should be amended to require representation of agriculture, small business, and labor on the Federal Reserve Board. To insure a unified national economic policy, the Federal Reserve System should be a part of the executive branch of government and made responsible directly to the President.

Chairman **Annunzio**. Mr. Long, I have a statement from you. Your entire statement that I have before me will be made part of the record, without objection.

Will you proceed in your own manner? Ms. Kobell, if you want a minute or two, I know the other panel members will not object. As far as this subcommittee chairman is concerned, I am ready to sit here to listen to all of you.

Ms. **Kobell**. Thank you. Earlier this year our national president, George Stone, had a series of nine field hearings to document not only what the conditions of rural America were in relation to farmers, but to small businessmen. We circulated that report entitled, "Depression in Rural America" to all Members of Congress.

Mr. Long is here, and I am delighted he can bring that message from rural America to you today.

STATEMENT OF R. HAL LONG, JOHN DEERE IMPLEMENT DEALER, GARBER, OKLA.

Mr. **Long**. Mr. Chairman and members of the subcommittee: I am R. Hal Long from Garber, Okla. My father became a John Deere farm implement dealer in 1934 at Garber, a wheat and cattle community in North Central Oklahoma, near Enid. My brother and I joined this business after military service and college and expanded into three other dealerships, with my son operating one at this time. High interest rates have become of great concern to us. Most implement dealers in our part of the country are not in a recession—they are in a depression.

I will give you two examples of what the high interest rates are doing to implement businesses. Our store with the biggest loss and most interest expense is not included, only the two which are the best capitalized and have consistently had the best profitability.

The Garber store's 7 month, year-to-date sales have dropped 56 percent as compared to the same period last year—from $2,317,000 to $1,034,000. Interest cost has risen by 81 percent—from $19,370 to $35,098. Profit has dropped by $147,000—from $48,000 profit to a $99,000 loss. Interest cost to sales has increased 4.25 times—from 0.8 percent to 3.4 percent. The 1971 interest cost to sales was only 0.8 percent—the same as last year.

The Blackwell store, which is located in Kay County, one of the outstanding agriculture counties in Oklahoma, has had much the same results with sales dropping 52 percent, interest expense rising by 100 percent, and profit dropping by $177,000 to a loss of $131,000 for the same 7 months.

Other than the obvious direct cost of interest to us, there are larger negatives with which to contend. It wasn't long ago that interest was 8 percent and inflation about 10 percent. Our static inventories, such as repair parts, a decent stock of new implements and a reasonable stock of used implements, would appreciate at about the same rate as the interest cost. At this time interest is 10 percent higher and inflation 5 percent lower—making a 15 percent swing in the cost versus appreciation on these inventories. We like the low inflation, but we can't handle the high interest.

Used implement inventories are not holding their own by several percentage points because the farmers are not able or willing to buy with interest rates as they are.

Implement manufacturers have been discounting new machinery to offset the high interest rates, and in many cases to generate cash flow so that they may survive, at least temporarily. This has had a negative effect on the implement dealer also by causing his high quality—high dollar used tractors in inventory to drop in price. Also some new sales have been made in lieu of what would probably have been a used sale. The profitability of the new sale involving a trade is very questionable and the used inventory has been increased rather than decreased. Hundreds of excellent used tractors are sitting on dealers lots which normally would have been sold at this time with the good prospects and crop which we have had. When a dealer cannot merchandise used equipment for whatever reason, he really can't sell new and stay in business.

It is estimated that 20 percent less implement dealers will be in business when times get back to normal. Towns like Garber cannot afford to lose its dealer. Like many other rural towns, the implement dealer and the farmers co-op are about all of the businesses left that hire many employees. Small town America is gasping for life.

Farmers tell us that they are not even buying repair parts until they have a costly breakdown because of the high interest rates—this is poor economics but our books show it is a fact. Futhermore, their tractors and implements are deteriorating excessively because preventive repairs are not made.

The hestitation to trade up is going to cause many small- and medium-sized farmers to be unable to compete when the farm economy is again normal. Each year that the farmer has to put off buying, it will make it harder for him to expand when the time comes that he will need to expand to survive. The effect of high interest rates it not only evident now but will be very damaging to the farmer's future.

Short of going out of business, most implement dealers cannot cut their costs appreciably and maintain any kind of service to their farmer customers who need service now more than ever. Of course inventories are being reduced when possible—sometimes at the customer's disadvantage—especially when repair parts are not put back in the bin and the customer has to lose precious hours or days waiting for his repair parts to arrive.

High interest rates have a very detrimental effect on the price of the farmers product which in turn makes it tough on the implement dealer. With the cost of interest at about 60 cents per year on a bushel of wheat and storage at 30 cents, the farmer has little choice about selling his wheat. Interest rates not only affect the overseas price and sale of wheat, but have a very definite affect on the local price.

For farmers, implement dealers, and our proud rural American heritage to survive, we must have lower interest rates immediately. To do this, we must expedite most, if not all of the following:

First, pass a balanced budget amendment with some flexibility; second, cut down on entitlements; and third, forgo the upcoming tax cut.

Thank you for your time and concern on such an important issue.

Chairman ANNUNZIO. Thank you for your excellent remarks, they are fitting. Sometimes people in the United States get a feeling that, and I understand it, no one is listening or no one cares, you see, and that is what the Government is about.

I don't want to get involved in supply side, no supply side.

This thing that bothers me today, people say, well, we don't need the Credit Control Act. We are not at war. Well, hell, this is war.

That is what you have all got to start selling. We are at war. We have got to bring this house in order.

The next witness is an old friend who has appeared before this committee many times, Mr. Schechter. I also enjoy your contributions. Mr. Schechter is director of the Office of Housing and Monetary Policy of the AFL-CIO.

STATEMENT OF HENRY B. SCHECHTER, DIRECTOR, OFFICE OF HOUSING AND MONETARY POLICY, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. SCHECHTER. I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Chairman ANNUNZIO. We have already reached 50 cosponsors. The list is growing every day.

Mr. SCHECHTER. I hope we can get more. We will keep trying.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. The AFL-CIO position was validated in 1980. Credit controls, introduced for about a 3-month period in 1980 under authority of the Credit Control Act of 1969, were helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started 2 months before the March 14, 1980, date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. After credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,555,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up. The modest use of credit control authority led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

However, with periodic public guidance from the Reagan administration, the Fed has steadfastly pursued a restrictive monetary policy in the past 18 months. In 16 of those months, the prime rate was in the 16 to 20 percent range and 2 months at 15¾ percent. Mortgage interest rates are at about 17 percent, and U.S. Treasury notes of 2 to 7 years carry 14 to 15 percent rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. There is a growing consensus that a meaningful recovery from this depressed economic condition is not possible without a significant reduction of interest rates.

There has also been a basic change in the economy that maintains economic demand for types of expenditures that can support high interest rates. There was a doubling of media family real income—measured in dollars adjusted for price changes—between 1947 and 1979; but also between 1967 and 1979–80, the share of total family money income going to the top 20 percent of the income distribution has climbed from 40.4 to 41.6 percent in 1979–80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A casual factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income consisting of interest income. Higher income families have more savings and investments and gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2 percent. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982 of all personal income was interest income.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent. There were stories about it in Business Week and U.S. News & World Report and other publications.

Historical data are shown in table 1 for five types of annual personal consumption expenditures that can be characterized as selected discretionary income expenditures for luxury goods and services. The five selected categories are for first, recreation including sports equipment, bikes, boats, and pleasure aircraft; second, other recreation including riding, skiing, and swimming places, and golf courses; third, foreign travel and expenditures overseas; fourth, airline travel; and fifth, jewelry and watch expenditures. The percentage of total personal consumption expenditures accounted for by the five categories in some benchmark years were: 2.5 percent in 1947; 2.9 percent in 1960; 3.7 percent in 1970; 4.1 percent in 1980, and 4 percent in 1981.

The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and service that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757's and 767's which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment.

Companies are actually saying they don't want to accept orders for the planes, as the economy goes through adjustment. These higher priced goods and services have a thin market, even though they cater to the higher income group, they are not essential, and part of the production capacity for such goods and services becomes idle.

As incomes rose to higher levels, there were upsurges in direct investments by households during high interest rate periods which had a depressing effect upon inflows into savings accounts in the fifties and sixties, before there were money market mutual funds of any significance. The amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some—such as commercial paper—which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, the trend has accelerated. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

The response of the political and financial policymakers has been to follow a policy of increasingly embracing monetarism, even though such a policy failed in England, which had a few years that proceeded our experiences.

Leading economists have concluded that major elements of inflation during the seventies, resulting from periodic worldwide oil and grain shortages, could not be controlled through the money supply. I would add that a domestic housing shortage is another major element of inflation that is caused by supply-demand imbalance which is aggravated by high interest rates. In fact, authorities such as Economics Nobel Laureate James Tobin, New York Federal Reserve Bank President Anthony Solomon, Harvard Prof. Benjamin Friedman, and Wall Street financial practitioners Henry Kaufman and Albert Wojnilower have questioned whether control over a given total of financial instruments that is defined as the money supply, including the volatile amounts in NOW accounts, can really bring about a return to stable economic growth.

The financial and credit market analysts and practitioners are searching, groping, and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics, including Fed authority to outlaw floating rate credit contracts and to establish punitive margin requirements on certain types of securities futures trading. On a broader scale, however, there are three specific sugestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. Albert Wojnilower notes that "Growth limits for certain types of credit (a la March 14, 1980) may also have some promise."

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments.

Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rate to combat inflation repeatedly has proven ineffective. The "window guidance" type of credit control that has been used in Japan and which we really used here in 1980, can rapidly bring down interest rates, as in 1980, as banks that are exceeding credit extension limits, but have funds to invest, buy securities, bidding up the prices and bidding down interest rates.

H.R. 6124 is needed to reestablish and strengthen authority that can bring down interest rates and restore noninflationary economic growth.

[Mr. Schechter's prepared statement, on behalf of the American Federation of Labor and Congress of Industrial Organizations, follows:]

Statement by Henry Schechter, Director
Office of Housing and Monetary Policy
American Federation of Labor and Congress of Industrial Organizations
on H.R. 6124, a Bill to Extend the Credit Control Act
Before the Subcommittee on Consumer Affairs and Coinage,
Committee on Banking, Finance and Urban Affairs,
U.S. House of Representatives

July 14, 1982

Summary

I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. The AFL-CIO position was validated in 1980. Credit controls, introduced for about a three-month period in 1980 under authority of the Credit Control Act of 1969, were helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started two months before the March 14, 1980 date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. After credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up. The modest use of credit control authority led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

However, with periodic public guidance from the Reagan Administration, the Fed has steadfastly pursued a restrictive monetary policy in the past 18 months. In 16 of those months, the prime rate was in the 16 to 20 percent range and two months at 15 3/4 percent. Mortgage interest rates are at about 17 percent, and U.S. Treasury notes of two to seven years carry 14 to 15 percent rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. There is a growing consensus that a meaningful recovery from this depressed economic condition is not possible without a significant reduction of interest rates.

There has also been a basic change in the economy that maintains economic demand for types of expenditures that can support high interest rates. There was a doubling of median family real income (measured in dollars adjusted for price changes) between 1947 and 1979; but also between 1967 and 1979-80, the share of total family money income going to the top 20 percent of the income distribution has climbed from 40.4 to 41.6 percent in 1979-80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A causal factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income consisting of interest income. As more of total income goes into interest payments, it is to be expected that the income share of total personal income going to higher-income families would increase. Higher income families have more savings and investments and gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures. Incidentally, the average family income in the top quintile is eight times that in the bottom quintile.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent, as reflected in the following excerpt from an article in Business Week of March 9, 1981.

> "Although high interst rates have increased the costs of consumer borrowing, they have also become an increasingly important source of income to growing numbers of consumers who put money in high-yielding money market funds or cash management accounts. Interest income as a percentage of total personal income increased by more than one-third from 1973 to 1980, going from 8.8% to 11.9%.
>
> "The two-tier consumer market is 'almost the sole reason consumer spending has outpaced forecasters' estimates,' says Albert G. Matamoros, vice-president and chief economist of Armstrong World Industries Inc. The weight of the top tier of the market in determining the strength of overall consumer spending is staggering.

Historical data are shown in Table I for five types of annual personal consumption expenditures that can be characterized as selected "discretionary income" expenditures for luxury goods and services. The five selected categories are for (1) recreation including sports equipment, bikes, boats, and pleasure aircraft; (2) "other recreation" including riding, skiing, and swimming places; and golf courses; (3) foreign travel and expenditures overseas; (4) airline travel; and (5) jewelry and watch expenditures. The percentage of total personal consumption expenditures accounted for by the five categories in some benchmark years were:

2.5 percent in 1947
2.9 percent in 1960
3.7 percent in 1970
4.1 percent in 1980
and
4.0 percent in 1981.

The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and services that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757s and 767s which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment.

As incomes rose to higher levels, there were upsurges in direct investments by households during high interest rate periods which had a depressing effect upon inflows into savings accounts in the fifties and sixties, before there were money market mutual funds of any significance. The amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some -- such as commercial paper -- which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, the trend has accelerated. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

Instead of addressing the changed economic conditions with a method of reestablishing some stability in financial markets and also reducing the economically injurious high level of interest rates, the response of the political and financial policy makers has been to follow a policy of increasingly embracing monetarism, even though such a policy had failed in England.

Leading economists have concluded that major elements of inflation during the seventies, resulting from periodic worldwide oil and grain shortages, could not be controlled through the money supply. I would add that a domestic housing shortage is another major element of inflation that is caused by supply-demand imbalance which is aggravated by high interest rates. In fact, authorities such as Economics Nobel Laureate James Tobin, New York Federal Reserve Bank President Anthony Solomon, Harvard Professor Benjamin Friedman, and Wall Street financial practitioners Henry Kaufman and Albert Wojnilower have questioned whether control over a given total of financial instruments that is defined as the money supply, including the volatile amounts in NOW accounts, can really bring about a return to stable economic growth.

The financial and credit market analysts and practitioners are searching, groping and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics, including "Fed" authority to outlaw floating rate credit contracts and to establish punitive margin requirements on certain types of securities futures trading. On a broader scale, however, there are three specific suggestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. Albert Wojnilower notes that "Growth limits for certain types of credit (a la March 14, 1980) may also have some promise."

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments.

Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rates to combat inflation repeatedly has proven ineffective. The "window guidance" type of credit control can rapidly bring down interest rates, as in 1980, as banks that are exceeding credit extension limits, but have funds to invest, buy securities, bidding up the prices and bidding down interest rates.

H.R. 6124 is needed to reestablish and strengthen authority that can bring down interest rates and restore noninflationary economic growth. In addition to extending the Credit Control Act of 1969 beyond its expiration date of June 30, 1982, amendments would clarify that the credit control authority could be used to bring down interest rates in order to fight high unemployment and recession, as well as to fight inflation, to preclude the use of credit for unproductive uses, such as corporate takeovers, and to assure greater credit availability for productive purposes.

* * * * *

I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. Experience over the past two years has validated the AFL-CIO position. A short, modest use of the credit control authority in 1980 led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

Credit Control Experience

Credit controls were introduced for about a three-month period in 1980 under authority of the Credit Control Act of 1969. The brief implementation of credit controls in 1980 was helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started two months before the March 14, 1980 date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. The seasonally adjusted annual rate of new housing starts declined from 1,844,000 in September 1979 to 1,040,000 in March 1980 and to a low point of 938,000 in May.

However, after credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up.

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments. In a recent study of the Japanese Financial System prepared for the Joint Economic Committee by a staff member of the Japanese Ministry of Finance, the author (Eisuke Sakakibara) speaking of monetary policy in Japan, states: "In addition to credit policy, the authorities often used window guidance to attempt to curtail bank loans directly. Although window guidance was sometimes heralded as a major policy instrument, it was actually only a supplementary tool. The Bank of Japan itself has said:

> 'Window guidance is a supplemental tool to general monetary policy tools such as discount rate changes, rather than an independent weapon of monetary control. In other words, while these tools exert pressure on the market, window guidance is a tool that reinforces them from the side. Since window guidance functions only as a supplemental tool of monetary policy, it would not be sufficiently effective unless it is used hand in hand with powerful enforcement of more orthodox tools of monetary policy."

Part of the credit controls implemented in the U.S. in 1980 were a fairly close copy of "window guidance" which has been used from time to time in Japan. Some of the more selective credit control measures used in Japan, when appropriate to promote stability, could also be used here under authority of the Credit Control

Act. Recently, for example, the authorities in Japan have forbidden the sale of zero coupon bonds in Japan, restricted the ability of Japanese banks to make loans denominated in foreign currencies, and tightened restrictions on yen-denominated loans to foreigners.

While credit controls are only one of many factors that influence the economic growth and stability, the use of the window-guidance type of controls for a brief period in the U.S. in 1980 indicated that it can be effective in bringing interest rates down quickly. This is almost bound to happen when banks are told that they cannot extend more than a given measure of credit in the current year (e.g., 106 percent of the amount extended last year). Those banks that are running beyond the limit and must slow down the extension of new credit, but have idle funds, must invest such funds. They will buy bonds and other interest bearing securities, bidding up the price of bonds and bidding down interest rates. That is why credit controls can be employed for a short period to bring down interest rates.

Japan has periodically used such controls over the last few decades. On the other hand, the United Kingdom and the United States have relied on restrictive monetary policy, as part of a monetarist economic belief in recent years. A few comparative economic indicators for these countries follow:

	Percentage Changes Over 12 Months			Prime
Country	Industrial Production	Consumer Prices	Unemployment Rate	Interest Rate (July 2)
United States	-8 (thru March)	+6.5 (thru May)	9.5% (thru June)	16.5%
United Kingdom	+1.25 (thru April)	+9.5 (thru May)	12.2% (thru June)	12.5%
Japan	+3 (thru April)	+2.5 (thru May)	2.4% (thru May)	6.3%

Recent Economic and Monetary Policies

Unfortunately, the harmful effects of persistent, prolonged tight money and high interest rates have never been more amply demonstrated than during the past

18 months. To test the Federal Reserve for steadfast adherence to a prescribed monetarist belief, the Reagan Administration not only admonished the Fed when it strayed from the straight and targeted path, but also pushed through legislation to cut out $750 billion in tax revenues and assure record triple-digit deficit financing.

The accomplishments under Reagan policies should be recorded. In five of the past 18 months, the prime rate was at 20 percent, in six months between 16½ and 20 percent, in two months at 15 3/4 percent, and in the last five months at 16½ percent. An upward trend has carried conventional mortgage rates from about 13½ to about 17 percent. The U.S. Treasury is paying between 14 and 15 percent on new issues of notes with maturities of two to seven years. The President did not authorize the use of credit controls to reduce interest rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. And, as the high interest rates take their toll, men and machines are idled in manufacturing, in construction, in extractive industries, and in farming. And the effects have spread to other economic activities.

Monetarism and Supply-Demand Impacts on Inflation

Housing, the most interest-sensitive economic product, has been produced at a rate far below national population growth and replacement requirements for over three years. The production shortfall and tight supply have made inflation in housing prices and rents a leading inflationary element, even today.

The recession-induced reduction of income and purchasing power and forced liquidation of inventories was bound to have had some downward price effects. There were also major effects of an accompanying worldwide oil glut and the luck of some bumper crops, to slow down energy price rises and actually reduce some food prices. For a few months the Consumer Price Index leveled off and victory against inflation was being claimed. However, reduced oil production by the OPEC cartel to dry up partially the oil glut, U.S. grain sales once more to help out the Russians, higher sugar price supports, and the continuing short housing supply have reignited inflation. In May, the Consumer Price Index rose a full one percent, a 12 percent annual rate.

The sources of oil and food price inflation during the seventies has been analyzed in a book published earlier this year by Brookings Institution, entitled Commodity Prices and the New Inflation by Bosworth and Lawrence. The authors point out that food price increases were preceded by the elimination of U.S. grain reserves and accompanied by a shift in Russian policy to more imports, plus some repeated bad crop years in Russia. They also point to 1973 and 1979 oil supply disruption and panic buying by consumer countries as basic factors in the rise in oil prices, as well as institutional changes (OPEC) in worldwide oil production and marketing. The authors are pessimistic about future possibilities of achieving stability in food and energy prices. They see the need for U.S. grain and petroleum reserves, and long-range bilateral agreements on magnitudes of access with potential large purchasers of U.S. grains, and for cooperative efforts by oil consumer nations to limit imports, as necessary to limit increases in spot prices. The dismissal of serious consideration of macro-economic monetary policy as a solution for inflation from supply-demand imbalances in markets for essential commodities reflects a realism which deserves general acceptance.

Adaptation of the National Financial Apparatus

That doesn't mean that monetary and credit policies aren't needed. It points to the need for present policy changes and modification, which historically has been the way that the national financial apparatus of the country has been adapted to changed economic conditions. In 1863, to deal with the problem of economic booms and busts stemming from operations by largely unregulated, state-chartered banks that financed land speculation, the National Banking Act was passed. Thereafter, banks, under national regulation and reserve requirements, were able to provide part of the necessary financing for extended post-Civil War industrial growth. However, it became apparent from financial panics in 1873, 1893, 1903, and 1907 that the financial system did not provide a sufficiently flexible money supply. In 1913 a radical innovation, the creation of the Federal Reserve System, took place. The authorization and powers and operation of the Federal Reserve System did not come down from on high; they were another adaptation of economic institutions to changing conditions in the American economy 69 years ago.

The 1929-33 economic debacle revealed that some additional shoring up of the financial mechanism was needed. Authority for the original Regulation Q was enacted to dampen a competitive escalation of interest rates paid on deposits by banks which drove them to reach for high-rate, high-risk loans. There was also a recognition that the savings institutions engaged in residential financing should have a source of secondary credit independent of the commercial banks. Otherwise, when the latter faced a liquidity crisis, mortgage financing and housing market activity were drastically curtailed. The Federal Home Loan Bank System was established. Deposit insurance and mortgage insurance were established.

As new economic conditions evolve, new problems arise. Since World War II, there have been recurrent credit-related deep declines in residential construction followed by general economic slowdowns or recessions. Such sequences developed in 1956-57, when there were federal budget surpluses and inflation was minimal; as well as in more recent periods, such as 1974-75; and in the last few years, when there were budget deficits and inflation was high. To dampen rising economic demands and prices, prior to each of the post-war recessions, the Fed tightened overall general monetary policy to restrict increases in credit extension to business and consumers. However, the overall effect of such policies has been highly selective. Residential and local public construction suffer a significant downturn. The automobile and farming sectors also are depressed. The high unemployment and reduced income generated in these sectors has adverse effects elsewhere in the economy.

Such sequences of events have contributed to economic slowdowns or recessions that spawned declines in real gross national product, in income, and in savings. Many billions of dollars, which could have been devoted to financing capital formation and additional housing, were foregone. The succeeding cyclical upswing then finds the economy with an inflation-feeding housing shortage and without the technologically advanced plants that support increased productivity.

To get out of the repetitive pattern that rocks the country between recession and inflation, with overlapping periods when both are present, an alternative or supplement to monetary policy is needed.

Before prescribing any changes, however, there has to be an identification of changes in economic conditions that have contributed significantly to the economic and costly instability of the seventies and the eighties.

Basic Changes in Economic Conditions

A strategic change in the economy was the development of affluence and economic literacy among a significant proportion of families, as there was a doubling of median family real income (measured in dollars adjusted for price changes) between 1947 and 1979. The family income distribution at the end of about three decades was not much different than at the beginning of the period. There had been a movement toward greater equality between 1947 and 1967 when the share of total family money income going to the top 20 percent decreased from 43.0 to 40.4 percent, but that share has since climbed back to 41.6 percent in 1979-80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A causal factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income that is interest income. As more of total income goes into interest payments, it is to be expected that the income share of total personal income going to higher-income families and households would increase. Surveys of consumer finances that have been conducted periodically over about three decades by the University of Michigan Survey Research Center have indicated that the value of financial asset holdings by families is correlated with family income levels. The correlation between interest income and family income levels is also indicated by the following data on median wage and salary income and median interest income, for families of different racial characteristics, from the Bureau of Census Current Population Reports for 1980:

Type of Family	Median Wage and Salary Income	Median Interest Income	Percent With Interest Income
All families	$20,229	$289	67
White families	20,942	308	71
Spanish-origin families	15,153	90	39
Black families	13,324	81	31

Thus, higher income families gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures. Incidentally, the average family income in the top quintile is eight times that in the bottom quintile.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent, as reflected in the following excerpt from an article in Business Week of March 9, 1981.

> "Although high interst rates have increased the costs of consumer borrowing, they have also become an increasingly important source of income to growing numbers of consumers who put money in high-yielding money market funds or cash management accounts. Interest income as a percentage of total personal income increased by more than one-third from 1973 to 1980, going from 8.8% to 11.9%.
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> "The two-tier consumer market is 'almost the sole reason consumer spending has outpaced forecasters' estimates,' says Albert G. Matamoros, vice-president and chief economist of Armstrong World Industries Inc. The weight of the top tier of the market in determining the strength of overall consumer spending is staggering. According to economist Carol Brock Kenney of Shearson Loeb Rhoades Inc., the richest 40% of all households account for 60% of all retail sales and two-thirds of all spending on such highly discretionary durables as automobiles and color TVs."

Not to be outdone, U.S. News and World Report in its issue of March 30, 1981, carried a large collection of such items, including the following:

> "Travel by the well-to-do also is booming. Economist Elisabeth Allison of Data Resources, Inc., in Lexington, Mass., says that money owed on travel and entertainment cards, used primarily by upper-income consumers, expanded at an annual rate of nearly 40 percent in November and December."

Historical data are shown in Table 1 for five types of annual personal consumption expenditures that can be characterized as selected "discretionary income" expenditures for luxury goods and services. The five selected categories are for (1) recreation including toys, sports equipment, bikes, boats, and pleasure

TABLE 1

TOTAL AND SELECTED TYPES OF PERSONAL CONSUMPTION EXPENDITURES 1947-1981

(millions of dollars)

YEAR	Personal Consumption Expenditures	Selected Discretionary Income Expenditures: TOTAL AMOUNT	Wheel Goods, Durable Toys, Sports Equipment, Boats and Pleasure Aircraft: AMOUNT	PERCENT OF TOTAL	"Other" Recreation[a]: AMOUNT	PERCENT OF TOTAL	Foreign Travel and Expenditures Abroad by U. S. Residents: AMOUNT	PERCENT OF TOTAL	Airline Travel: AMOUNT	PERCENT OF TOTAL	Jewelry and Watches: AMOUNT	PERCENT OF TOTAL
1947	161,742	3,800	955	0.6	574	0.4	785	0.5	91	0.1	1,395	0.9
1948	174,749	4,013	965	0.6	594	0.3	979	0.6	101	0.1	1,374	0.8
1949	178,135	4,125	886	0.5	594	0.3	1,231	0.7	116	0.1	1,298	0.7
1950	191,966	4,238	889	0.5	624	0.3	1,266	0.7	141	0.1	1,318	0.7
1951	207,066	4,880	897	0.4	852	0.4	1,531	0.7	188	0.1	1,412	0.7
1952	217,093	5,305	989	0.5	691	0.3	1,876	0.9	226	0.1	1,523	0.7
1953	229,665	5,972	1,090	0.5	755	0.3	2,301	1.0	266	0.1	1,560	0.7
1954	235,842	6,243	1,174	0.5	793	0.3	2,347	1.0	298	0.1	1,631	0.7
1955	253,666	6,899	1,386	0.5	887	0.3	2,534	1.0	349	0.1	1,743	0.7
1956	266,008	7,495	1,573	0.6	981	0.4	2,735	1.0	394	0.1	1,812	0.7
1957	282,409	7,976	1,720	0.6	1,086	0.4	2,908	1.0	445	0.2	1,817	0.6
1958	289,461	8,363	1,845	0.6	1,181	0.4	3,008	1.0	479	0.2	1,850	0.6
1959	310,773	9,032	2,006	0.6	1,338	0.4	3.179	1.0	589	0.2	1,920	0.6
1960	324,507	9,432	1,976	0.6	1,500	0.5	3,376	1.0	676	0.2	1,904	0.6
1961	344,997	9,558	1,944	0.6	1,653	0.5	3,325	1.0	760	0.2	1,876	0.5
1962	355,219	10,337	2,015	0.6	1,818	0.5	3,605	1.0	882	0.2	2,017	0.6
1963	374,581	11,096	2,180	0.6	2,007	0.5	3,853	1.0	924	0.2	2,132	0.6
1964	400,497	12,287	2,520	0.6	2,223	0.5	4,118	1.0	1,044	0.3	2,382	0.6
1965	430,378	13,594	2,988	0.7	2,387	0.6	4,589	1.1	1,191	0.3	2,639	0.6
1966	465,118	15,539	3,620	0.8	2,709	0.6	5,067	1.1	1,329	0.3	3,114	0.7
1967	490,262	17,838	4,055	0.8	2,957	0.6	5,860	1.2	1,582	0.3	3,354	0.7
1968	534,883	19,754	4,730	0.9	3,503	0.7	5,930	1.1	1,892	0.4	3,699	0.7
1969	551,781	22,035	5,165	0.9	4,071	0.7	6,588	1.1	2,337	0.4	3,874	0.7
1970	621,721	23,574	5,146	0.8	4,593	0.7	7,443	1.2	2,450	0.4	3,942	0.6
1971	672,242	25,555	5,573	0.8	5,102	0.8	7,948	1.2	2,694	0.4	4,238	0.6
1972	737,154	29,406	7,294	1.0	5.606	0.8	8,812	1.2	3,108	0.4	4,586	0.6
1973	811,964	32,702	8,281	1.0	6,487	0.8	9,019	1.1	3,533	0.4	5,382	0.7
1974	888,111	35,830	8,705	1.0	7,358	0.8	9,757	1.1	4,137	0.5	5,873	0.7
1975	976,449	39,050	9,724	1.0	8,273	0.8	10,280	1.1	4,375	0.4	6,398	0.7
1976	1,084,271	43,644	10,769	1.0	9,462	0.9	10,797	1.0	5,271	0.5	7,345	0.7
1977	1,205,483	49,187	12,171	1.0	10,204	0.8	11,869	1.1	6,101	0.5	7,842	0.7
1978	1,348,717	54,223	13,905	1.0	11,445	0.8	13,051	1.0	6,912	0.5	8,910	0.7
1979	1,510,838	60,657	15,699	1.0	12,951	0.9	14,254	0.9	8,076	0.5	9,677	0.6
1980	1,672,766	68,884	15,446	0.9	14,581	0.9	18,505	1.1	10,326	0.6	10,026	0.6
1981	1,858,153	73,910	16,195	0.9	16,093	0.9	17,338	0.9	12,355	0.7	11,929	0.5

[a] Consists of billiard parlors, bowling alleys, dancing, riding, shooting, skiing and swimming places; amusement devices and parks; golf courses; sightseeing buses and guides; private flying operations; and other commercial participant amusements.

SOURCE: U. S. Department of Commerce

aircraft; (2) "other recreation" including bowling alleys, riding, skiing, and swimming places; amusement parks, golf courses and sightseeing buses; (3) foreign travel and expenditures overseas; (4) airline travel; and (5) jewelry and watch expenditures. The proportion of total personal consumption expenditures accounted for by these five categories in some benchmark years were:

2.5 percent in 1947
2.9 percent in 1960
3.3 percent in 1965
3.7 percent in 1970
4.0 percent in 1975
4.1 percent in 1976
4.2 percent in 1977
4.0 percent in 1978
3.9 percent in 1979
4.1 percent in 1980
4.0 percent in 1981

The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and services that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757s and 767s which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment. Airlines are now deferring deliveries or canceling orders.

A smaller current example, announced June 28 (in The Wall Street Journal), is the expansion of a credit line by Western Savings and Loan Association to a camp ground operator, Thousand Trails, Inc., from 25 to 50 million dollars, in return for acquiring 370,000 shares of Thousand Trails common stock, valued at $3.7 million, for cash and securities. Camp ground site rentals can bring a higher return than housing mortgages.

Changes in Investment Channels

The historical evidence clearly indicates that the evolution of increased household influence and decreased depository institution influence over loanable fund placement took place well before the existence of money market funds. One of the earliest manifestations of growing direct investment in credit market securities by households was in 1959 when individuals withdrew funds from thrift institutions and lined up in front of the New York Federal Reserve Bank to purchase "magic fives" -- U.S. Treasury notes with an interest rate of 5 percent, which was then above rates being paid on time and savings deposits.

It should be noted that the upsurges in direct investments during high interest rate periods had a depressing effect upon inflows into savings accounts in the fifties, sixties, and early seventies, before there were money market mutual funds of any significance. And the amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next:

$7.8 billion in 1955
11.6 billion in 1959
17.1 billion in 1966
31.3 billion in 1969

It was inevitable that new institutions would arise to cater to the growing desire of households to shift their increased funds around in pursuit of higher yields. If it hadn't been the original type of money market funds, it would have been Merrill, Lynch or Sears, Roebuck or some other institution that responded.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some -- such as commercial paper -- which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy which caused slowdowns in deposit growth or net outflows at depository institutions during tight money, high interest rate periods. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, with the recent acceleration of the trend, the total of direct net investments in market securities plus money market funds rose from $65 billion in 1978 to $121 billion in 1979, while net inflows to time and savings accounts declined from $100 billion to $79 billion. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

The failure during the seventies of the thrift industry and public policy makers to focus on conditions and forces that go beyond the operation of financial institutions has been a significant factor in bringing the thrift institutions to a position of vulnerability in the eighties.

Effects of Interest Rates and Monetary Policy on Economic Activities

There were repeated demonstrations that borrowers of capital funds for nonhousing uses could pay higher rates and attract funds away from residential mortgage lending. Disintermediation of funds from S&Ls and mutal savings banks occurred during months of the 1973-74, 1979-80, and 1981-82 tight money periods. Funds flowed to higher rate investment outlets through direct investment by more educated and affluent household depositors, or through routes such as the money market funds that bought commercial bank CDs and commercial paper. Both of the latter channels provided financing for business activities.

Issuance by the thrift institutions of six month money market certificates with rates linked to Treasury bill rates provided another demonstration that they could not compete with other institutions serving nonhousing capital needs, because the home buyer (and rental) housing market was too limited at competitive market interest rates in high double-digit ranges. Nor can adjustable rate mortgages solve the problem of sharp credit related cyclical housing declines when initial mortgage interest rates are at levels beyond the reach of a large proportion of the potential housing market.

Business borrowing for investment is the strong influence that sets off and supports a cyclical upturn in interest rates that has periodically depressed housing construction as prospective home buyers are squeezed out of the market. Chart 1 shows the repeated sharp downturns in housing starts after there has been some upswing in the volume of real nonresidential fixed investment. At that stage, interest rates have been rising and the Federal Reserve usually adopts a tighter monetary policy to dampen the inflationary pressures caused by an expanding economy. Housing demand and construction decline sharply. Construction unemployment increases much more rapidly than total unemployment (Chart 2), to help lead the economy into a slowdown or recession.

Another interest-sensitive sector, automobile production, shares the roller coaster experience pattern of residential construction. Chart 3 shows the inverse relationship between automobile production and interest rates. Like residential construction, automobile production declined in 1966-67, 1969-70, 1974-75, 1979, and 1981-82.

Sharp declines, as shown in Chart 4, in manufacturing capacity utilization, to about 70 percent, occur in such supplier industries as iron and steel, and clay, glass, and stone, during periods when automobile and housing market demands decline. And even sharper related fluctuations occur in production of items used by manufacturers, such as electrical machinery. As the effects are felt throughout the economy, total manufacturing capacity utilization declines.

Criticisms of Current Monetary Policy and Recommended Remedies

Instead of addressing the changed economic conditions with a method of reestablishing some stability in financial markets and also reducing the economically injurious high level of interest rates, the response of the political and financial policy makers has been to follow a policy of increasingly embracing monetarism, even though such a policy had failed in England.

CHART 1

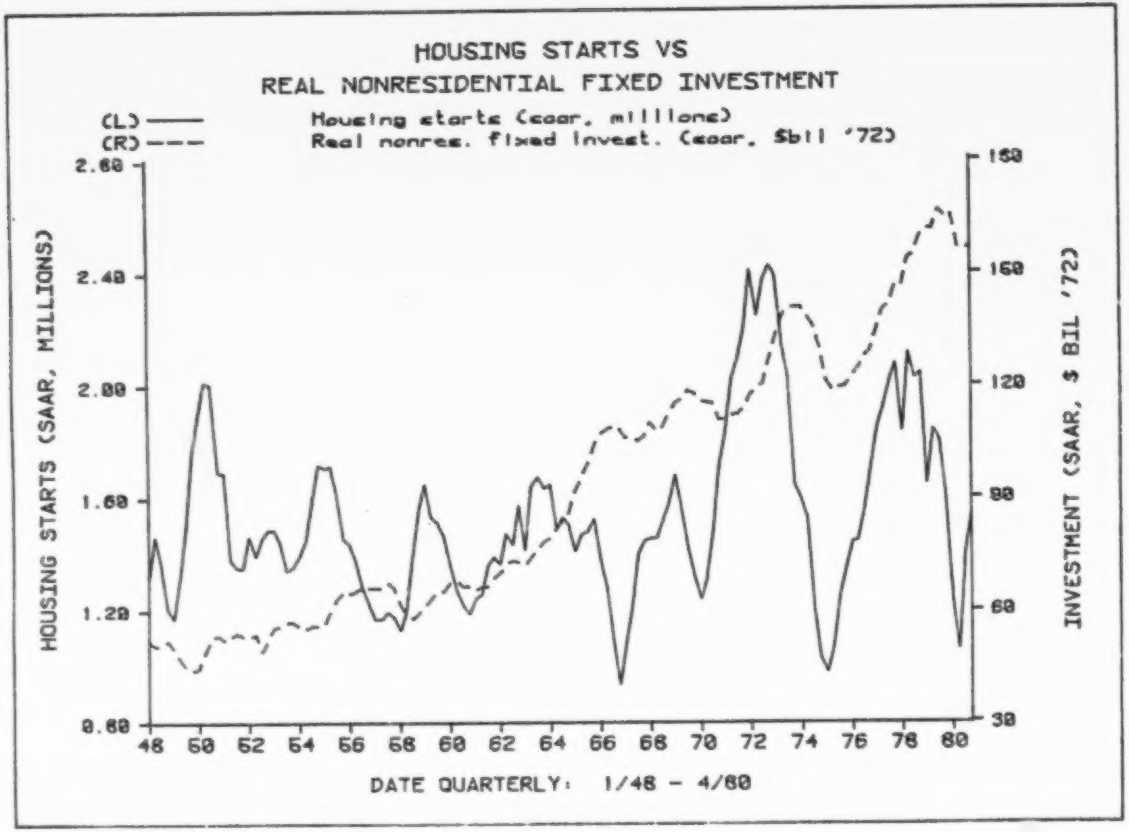
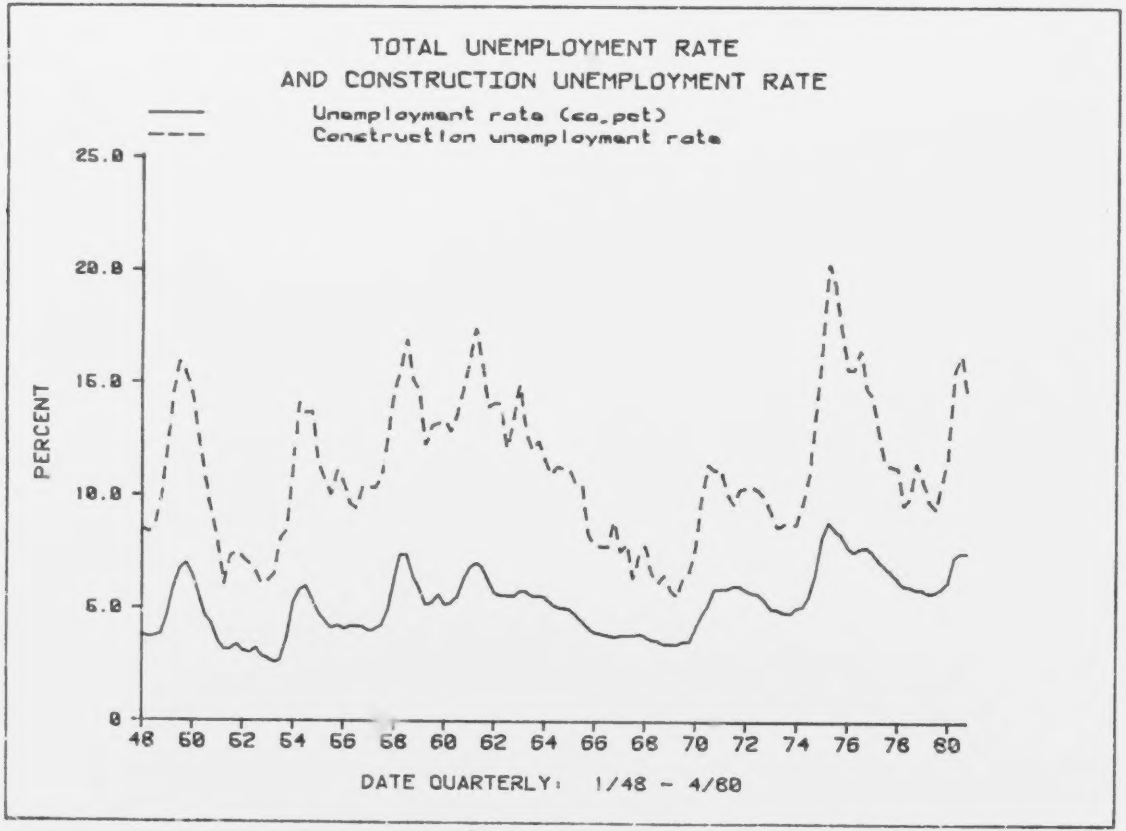
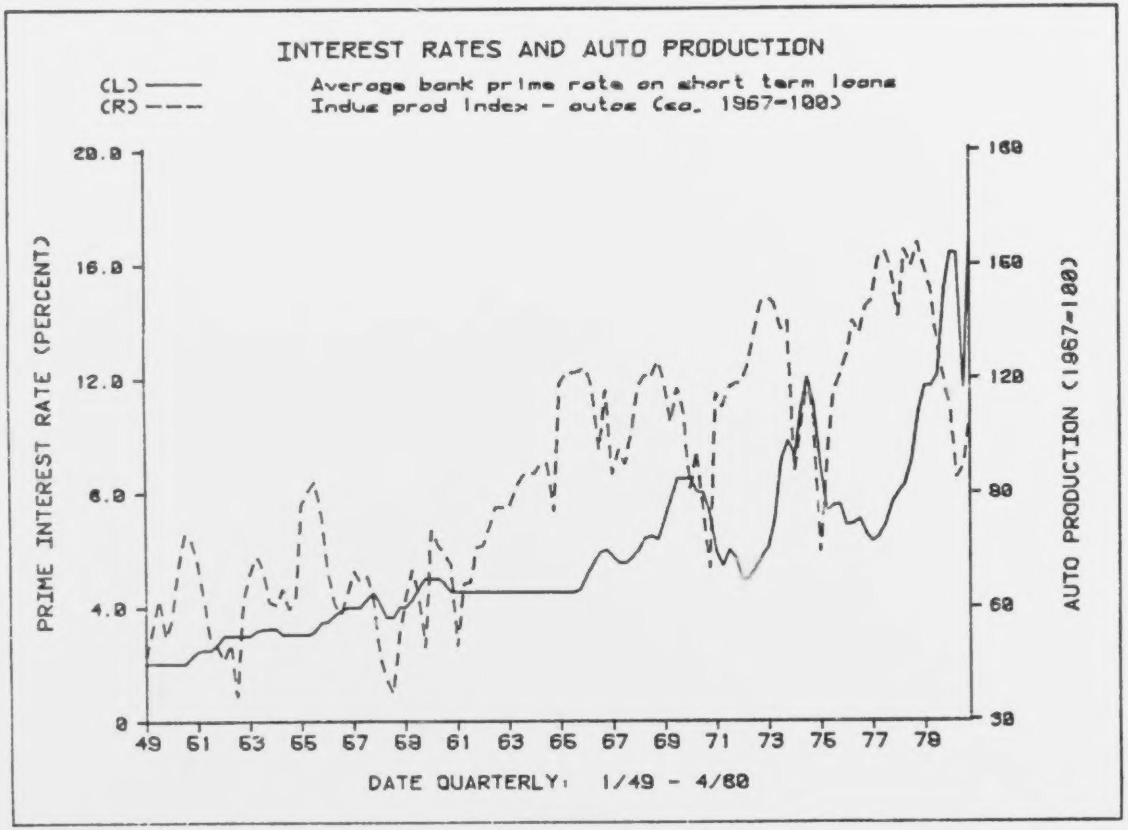

HOUSING STARTS VS
REAL NONRESIDENTIAL FIXED INVESTMENT
(L) —— Housing starts (saar, millions)
(R) - - - Real nonres. fixed invest. (saar, $bil '72)
HOUSING STARTS (SAAR, MILLIONS)
2.80
2.40
2.00
1.60
1.20
0.80
INVESTMENT (SAAR, $ BIL '72)
180
160
120
80
60
30
48
50
52
54
56
58
60
62
64
66
68
70
72
74
76
78
80
DATE QUARTERLY: 1/48 - 4/80

CHART 2



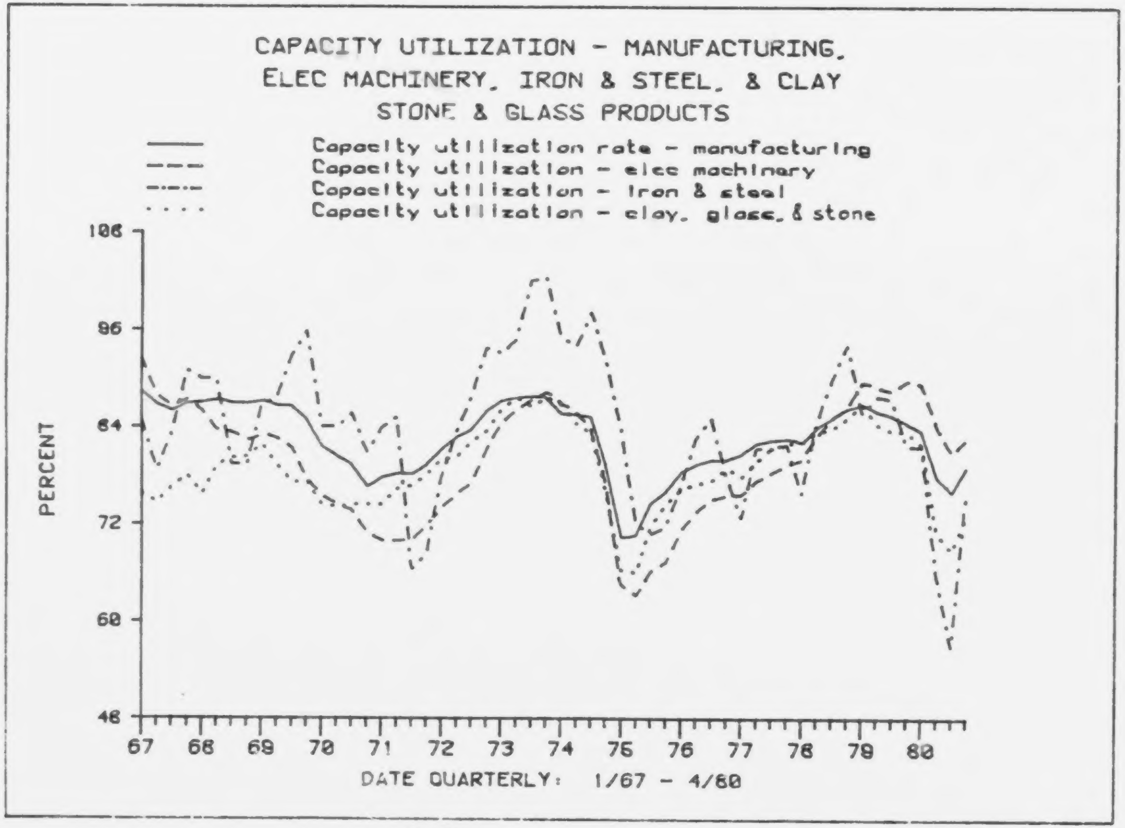
TOTAL UNEMPLOYMENT RATE
AND CONSTRUCTION UNEMPLOYMENT RATE

CHART 3



BEST DOCUMENT AVAILABLE

CHART 4



CAPACITY UTILIZATION - MANUFACTURING, ELEC MACHINERY, IRON & STEEL, & CLAY STONE & GLASS PRODUCTS

In a hearing on "Monetarism in the United States and the United Kingdom" before the Joint Economic Committee of the Congress, in October 1981, James Tobin, the 1981 Nobel Laureate in Economics, said:

> "The folly of staking credibility on particular monetary aggregates has been dramatized by events in both the U.K. and the U.S. In recent years rapid innovations in transactions technology, financial institutions, and government regulations have radically altered demands for and supplies of various bank deposits and the degrees of substitutability among them and between them, the liabilities of nonbank intermediaries, and open market paper. The Federal Reserve tried to cope with these changes by redefining monetary aggregates, an exercise which clearly illustrated the conceptual confusions and statistical ambiguities inevitably involved in drawing a sharp line between things labelled 'money' and other assets.
>
> "No sooner was the exercise completed than further innovations destroyed the continuity of meaning of the new aggregates."

Later in his testimony, in dealing with the meaning of the pursuit of the current Reagan-Volcker monetary policies, Tobin said:

> "Chairman Volcker's true message is that the Fed will stick with its disinflationary policy no matter what. No matter how long it takes, how much unemployment it takes, how deep a recession it takes, the Fed will not rescue the economy until inflation has been expunged. This is also Mrs. Thatcher's policy, and so far the wreckage of the British economy has not lessened her resolve."

Other well-known and highly respected scholars and practitioners of finance have also challenged the continued pursuit of present monetary policies and have called for modifications.

In a September 1980 article in The Banker, Robert Roosa, former Under Secretary of the Treasury, and Bruce Jackson, speaking of the 1980 credit controls, said they "had become necessary because the customary weaponry for control over the growth of bank-created money had been deployed so mechanically during the seventies that Federal Reserve action had become in effect an accelerating force within an inflation that it was ostensibly designed to check." As they point out, each time that the Federal Reserve moved to tighten the money supply, the markets came to expect further tightening, and there was anticipatory borrowing, calling for another increase in the federal funds rate. They also pointed out that "at any given time, close adherence to a target range (of money supply growth) would prevent the use of calculated influences on liquidity to induce offsetting changes in spending or investing behavior whenever cyclical or external factors might have produced unwanted changes in prices, capital formation, or production." There were also periods in the seventies when a rapid increase in the velocity of money use would partially offset adherence to a restrictive money supply growth target. That combination of events, incidentally, occurred in 1981.

Another distinguished financial economist, Albert Wojnilower of the First Boston Corporation, wrote a lengthy article, "The Central Role of Credit Crunches in Recent Financial History" which was published in *Brookings Papers on Economic Activity, 2; 1980*, in which he pointed out that, "Since the United States has subscribed to a monetary aggregates policy, the trend of monetary growth, inflation, interest rates -- and unemployment -- has been upward. ...the record as described here would suggest that only policy constraints that have a direct understandable message will be effective." He ended up by calling for limits on interest rates, loans and other controls to be used from time to time as supplements to money supply controls. Some of his specific selective tools would include outlawing floating rate credit contracts and punitive margin requirements on futures transactions. He also notes that growth limits on certain types of credit (as under March 1980 credit controls) may also hold some promise.

At the December 1981 meeting of the American Economic Association in Washington, there were two noteworthy presentations dealing with the question of monetary policy. In a paper entitled, "New Strategies for the Federal Reserve?", Anthony Solomon, President of the New York Federal Reserve Bank, noted:

> "The formulation of one-year targets for growth in money stock measures (along with an 'associated' target for bank credit) seeks to provide a coherent monetary response to endemic inflation. It reflects the perception that on the monetary side at least, a slowdown in the trend rate of money growth is a necessary condition for restoring price stability. As an approach, however, it makes no commitment to any particular theory of the underlying causes of inflation, to the possible need for other anti-inflation policies, or to the needed precision of monetary control."

Solomon also dealt at some length with the difficulties of interpreting the meaning of the divergent growth paths exhibited by different measures of the monetary stock. There is also a problem of new instruments of money and credit, he noted, some of which are not encompassed by monetary aggregates that are readily subject to monetary policy influence. Furthermore, as the defined list of instruments subject to control by monetary policy measures is broadened, new evasive innovations are invested. In discussing various alternative monetary aggregates, Solomon writes:

> "Another possibility would be to replace the money targets with a measure of credit, perhaps bank credit, credit extended by all depository institutions or some still broader credit measure. But with liability management by banks and other financial institutions, and with variable rate lending and the absence of reserve requirements on many major funding sources, the question again arises whether bank credit can be controlled."

In his concluding remarks, Solomon observed that in the current world, policy influences the economy primarily through the effects of credit cost rather than availability; that interest rates must move further in order to achieve an effect; and financial fragility seems to have increased because institutional adaptations to a floating-rate environment seems imperfect.

I would add that a floating-rate environment is a modern variation of the prevalence of unamortized balances that had to be refinanced at prevailing rates in the late twenties, and it is the entire economy which must encounter difficulty in adapting, rather than just the institutions.

Another paper presented at the American Economic Association December 1981 meeting was by Professor Benjamin Friedman of Harvard University. He had spent two years doing research and analysis to develop his findings in a paper entitled, "Time to Re-examine the Monetary Targets Framework." Some of his conclusions were similar to those of previously mentioned authors. Thus, he points to the destabilizing, inflationary effects of reduced oil and grain supplies in the seventies, which could not be countered by restricting aggregate demand through tight money (as do Bosworth and Lawrence). He joins Solomon in pointing to redefinitions of the money aggregates as evidences of difficulty in measuring the money growth, and Friedman emphasizes that any arbitrarily chosen monetary aggregate does not necessarily correspond to what matters for gauging the effects of monetary policy upon the economy. Professor Friedman also cites data of recent periods which show that the relationship between money and prices has not held, that financial market behavior is no more stable or predictable than real spending behavior --especially when there are massive shifts into or out of NOW accounts.

Benjamin Friedman, therefore, searched for an alternative or supplement to the monetary supply that the Federal Reserve could influence. He found that the "aggregate outstanding indebtedness of all nonfinancial borrowers" in the U.S. has just as close and stable a relationship to total nonfinancial activity as the money supply. He proposes that the Federal Reserve, in trying to exercise its function of promoting economic stability, should adopt a two-target approach: the money supply growth and credit growth, as already required by the Humphrey-Hawkins Act. In order to influence both targets, the Fed would provide more or less bank reserve funds -- a difficult task.

(It should be noted that in fulfillment of the Humphrey-Hawkins credit target requirement, the Federal Reserve Board sets a bank credit growth target "corresponding target range" to that of M-3, the broad monetary aggregate which includes commercial bank securities repurchase agreements and balances of money market mutual funds -- which are not subject to great control by present monetary policy tools.)

Another articulate critic of the protracted pursuit of a monetarist policy is Henry Kaufman, the noted Wall Street practitioner of economics with Salomon Brothers. He expressed his views in an article entitled, "Danger: Too Much Turbulence," in the May-June 1982 issue of Challenge. In the current dangerous, high debt situation he highlights the enormous credit liabilities of households, governments, and businesses; the low level of corporate liquidity; increased federal demands in credit markets; highly leveraged financial institutions; and high business vulnerability due to excessive short-term business financing.

Given the foregoing conditions, Kaufman identifies four worrisome interest rate aspects: (1) extraordinarily high rates after a year of recession; (2) unprecedented volatility of rates; (3) frequent negative yield curves, causing financial institutions to shift to variable rate, "spread banking"; and (4) high "real interest rates," imposing an increasing burden upon business cash flow.

Kaufman notes (along with others) that monetarism has encouraged financial innovations to escape more costly monetary regulation, necessitating catch-up redefinitions of the money supply by the Federal Reserve. He then points to specific monetary policy shortcomings: (1) no credit restraints other than interest rates; (2) the absence of long periods of positively sloped yield curves that helped in previous recessions and recoveries; (3) with the sole restraint of interest rates, the credit system cannot be reliquified during business contractions and early recoveries; and (4) "spread banking," shifting risk of interst rate changes to borrowers through variable rate loans, eliminates an important factor in prudent fiduciary behavior by lenders.

Believing that a brand new approach to monetary policy is needed, Kaufman recommends that in lieu of present monetary targets, there should be substituted the total of credit market instruments, deposits, and currency held by private domestic nonfinancial investors because such a target provides a closer link with total GNP. In addition, to restore fiduciary responsibility all major financial institutions should have to maintain varying capital ratios, and the proliferation of short-term debt has to be curbed. Toward these ends, Kaufman recommends certain selective credit regulations: (1) phase out all lines of credit supporting the issuance of commercial paper; (2) require commercial banks to maintain capital ratios on contractual unused lines of credit; (3) impose reserve requirements on money market funds; and (4) give the Federal Reserve discretion to regulate margin requirements in the financial futures and options markets.

Credit Control Authority is Needed as a Periodic Remedy

As indicated in the preceding summary, an increasing number of authoritative voices have found the present aggregate monetarist policies to be ineffective in fighting inflation stemming from supply-demand imbalances in sectors such as food and energy. Furthermore, it has been noted that the prolonged high-interest rate environment, which is the cutting edge of the present monetary policy -- and is likely to be prolonged further in the two-tiered U.S. economy -- poses dangers of a financial collapse among financial institutions and nonfinancial business corporations which can drag the entire economy into a deeper, longer depression.

The financial and credit market analysts and practitioners end up searching, groping and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics for "Fed" authority for maintenance of bank capital ratios against credit commitments, outlawing floating rate credit contracts and establishing punitive margin requirements on certain types of futures investments. On a broader scale, however, there are three specific suggestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. However, two of the three authors do not go into the necessary implementation to achieve such credit targets, and the third (Anthony Solomon) raises the question whether bank credit can be controlled. A fourth analyst (Albert Wojnilower) notes in a footnote that "Growth limits for certain types cf credit (a la March 14, 1980) may also have some promise."

On July 6, The Wall Street Journal published the end-of-1982 interest rate forecasts of 15 economists from large banks and economic consulting firms. Eleven of them had had prime rate forecasts ranging from 15 to 16½ percent, only one was as low as 14 percent, and the other three forecasts were between 14 and 15. Such interest rates would not provide much relief to businesses or governments overburdened with high debt service obligations. They would not permit a revival of the home building or auto manufacturing and their supplier industries. They would assure that many more farmers would lose their farms and unemployed or underemployed workers, especially those with variable rate loans, would lose their homes because they cannot continue to meet high interest costs. They would push many financial institutions and corporations over the brink of bankruptcy, and create a danger of prolonged economic depression.

H.R. 6124 is needed to retain and strengthen authority that can bring down interest rates and restore noninflationary economic growth. In addition to extending the Credit Control Act of 1969 beyond its expiration date of June 30, 1982, amendments would clarify that the credit control authority could be used to bring down interest rates in order to fight high unemployment and recession, as well as to fight inflation, to preclude the use of credit for unproductive uses, such as corporate takeovers, and to assure greater credit availability for productive purposes. Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rates to combat inflation has proven ineffective time and again. It is ineffective because the high interest rates directly and indirectly add to inflation as they are rolled into the prices of goods and services, as well as required on mortgage and consumer credit loans. It has become more ineffective because a two-tiered economy has developed which maintains certain economic sectors supported by discretionary incomes, that are kept at high levels by high interest rates which are kept in effect for a long time. The end result is serious recession and a potential prolonged depression.

Credit control authority is needed, so that it can be used to help restore economic recovery with stability and help the country become more productive and internationally competitive. The President should have the authority.

For all of the foregoing reasons, the AFL-CIO urges you to approve H.R. 6124.

Chairman ANNUNZIO. Thank you very much, Mr. Schechter, for an outstanding statement.

Our next witness, Mr. Sheldon Friedman, research director of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America.

STATEMENT OF SHELDON FRIEDMAN, RESEARCH DIRECTOR, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA-UAW

Mr. FRIEDMAN. Thank you, Mr. Chairman. I appreciate this opportunity to present the UAW's views on credit controls and monetary policy.

We strongly support H.R. 6124, which would reestablish standby credit control authority, and we are especially pleased with the features of this bill, which would include recession and unemployment triggers as well as provide credit targeting provisions.

The monetarist doctrine that has been pursued by our Federal Reserve Board since October 1979, and more recently with the strong encouragement of the Reagan administration, has been an unmitigated disaster.

It is, without doubt, the greatest single factor underlying what has become the worst recession since the Great Depression. It has led to the highest and most erratic interest rates in our Nation's history, with devastating consequences for the economy. Right now, we have a real prime interest rate in excess of 11 percent.

We urge rejection of this monetarist doctrine and refocusing of monetary policy to provide adequate credit to allow the economy to expand and grow, and credit that is available at the reasonable interest rates.

Credit controls are a necessary tool in conjunction with this refocusing of monetary policy. It would be extremely important for the Federal Reserve Board to have standby authority to restrict access to credit for nonproductive and speculative applications, and to direct access to such productive applications as car loans at affordable interest rates.

The cost of monetarism to our economy is incalculable. It has been estimated that in order to cut inflation by only 1 percent via monetarist recession, the loss to the economy is a staggering $200 billion in GNP. Even that is an ephemeral gain as interest rates drive up costs, and the slump that results cuts supply, leading to further inflation down the road.

Workers have been the chief victim of monetarism. We face the worst unemployment since the Great Depression. If you count in the discouraged workers and those workers who are involuntarily working part-time, but would prefer to be working full-time, we have some 17.4 million unemployed in this country today, an incredible 15.6 percent of the potential labor force.

The AFL-CIO has estimated that some 30 million American workers will face unemployment lines sometime during 1982. Of our Nation's manufacturing capacity, 30 percent stands idle. In auto, it is a staggering 46 percent, and in steel, 51 percent, the highest such figure ever recorded.

Mortgage delinquencies are at a record rate; bankruptcies are the highest since the 1930's, and not only small but also some quite large and well-known corporations are threatened.

Capital spending is sluggish at best. Those corporations that have any cash are investing it in high interest-bearing, short-term money market investments rather than committing funds to long-term productive investments.

The impact of this devastating monetarist experiment has been very, very unfair on particular sectors of our economy that are vitally dependent on credit, and doubly unfair on those sectors that are both credit-sensitive and exposed to international trade, such as the automobile industry. The punishingly high interest rates have not only had a direct impact on those industries, but they have adversely affected the international trade situation through the artificial strengthening of the dollar that has resulted from our terribly high interest rates, weakening our exports and giving stimulus to imports.

In auto, we are in the 40th month of a disastrous slump without precedent since the Great Depression, and although that has many causes, including skyrocketing imports, among the most serious and significant causes are tight money and skyrocketing, sky-high interest rates.

Looking at car sales, since 1978, which was the last really good year we had, domestic car sales in the year 1981 were down 32 percent to the lowest level in 20 years. We sold only some 6.2 million domestic-made cars in this country last year.

With respect to trucks, the situation is even worse. The downturn was 53 percent in 1981, compared with 1978.

With respect to cars, we face, unbelievably enough, an even further downturn in 1982. Nobody believed the situation could get worse in the automobile market in 1982 than it was in 1981, but, in fact, it has gotten substantially worse. For the month of June, the latest figures we have, there was an incredible 13-percent decline in domestic car sales, even below the terribly depressed sales figures of June 1981.

It is very clear that interest rates have been a significant factor in the desperate situation that the auto industry and auto workers find themselves in.

I would like to illustrate this for you with respect to the interest costs to finance a new car purchase. If you consider a $6,500 car note over a 4-year period, the difference between a 12-percent rate of interest on that note and a 16½ percent rate, which is the current rate, is nearly $1,000 over the 4 years of the note—an increase in interest expense of 82 percent.

It costs 82 percent more in interest expenses over the life of that note with interest rates at 16½, compared to interest rates at 12.

As you noted in your opening remarks, Mr. Chairman, General Motors' interest rate in the incentive plan introduced April 1 had a very significant effect on the market—showing yet again evidence of the strong link between interest rates and motor vehicle sales. In March, before they introduced their 12.8-percent financing plan, GM sales were a dismal 20 percent below March 1981.

The plan then became effective on April 1, and in the last 20 days of April, sales picked up 7 percent over the year-earlier figure, and in the month of May, sales were a full 22 percent ahead of May 1981.

Then on May 31, the program expired, and June sales plummeted 17 percent below the level of June of 1981.

Further evidence of the interest and credit sensitivity of auto purchases is provided by the University of Michigan survey of consumers, which found that one-third of all consumers were postponing purchases, mainly of homes and cars.

As a result of the incredible depression conditions in auto, we have staggering unemployment, which amounts right now to 220,000 workers on indefinite layoff at the original equipment car manufacturers—GM, Ford, VW, Chrysler, American Motors. Production-worker employment in the industry has declined by approximately one-third since July of 1979. If you throw in white-collar workers and the supplier workers who have been affected by the downturn in auto, we estimate that there has been a loss of approximately one million jobs related to the auto crisis, including steel, rubber, aluminum, et cetera.

The financial crunch has had a tremendous impact on the corporations' balance sheet. The Big Four domestic auto makers have sustained a cumulative loss of $5.6 billion since 1980. Their interest expenses and debts have gone through the roof. Capital spending, meanwhile, has been trimmed back radically. At the beginning of this year, it was projected that capital spending in the first half by the auto makers would total some $12.2 billion. Conditions have gotten so bad they have not been able to finance it, and they have trimmed that way back to $9.2 billion and anticipate a further drop of $8.2 billion capital spending in the second half of this year. We are mortgaging the future of this industry, and with it the jobs of many more thousands of our members.

There are numerous suppliers to our industry and some 3,700 auto dealers who have gone out of business since early 1979—15 percent of the total dealer body.

The catastrophic impact of high interest rates and tight money has not been limited to auto. Other UAW industries have been very greatly affected, farm equipment being a leading case in point. Farmers have been squeezed by depressed farm income and skyrocketing interest rates.

Equipment purchases have been deferred by farmers to the extent that their repair bills now cost them half as much as their new equipment purchases, an unprecedented ratio.

If you look at the decline in unit sales for 1981 versus 1979, in the case of tractors, down 25 percent; combines, 17 percent; balers down 47 percent; harvesters down 39 percent. That decline is continuing so far in 1982: Tractor sales are off 20 percent, compared with the same months of 1981; combines down 40 percent; balers down 42 percent; and harvesters down 27 percent.

With respect to construction equipment, an industry trade association recently predicted double-digit unit sales declines in all major categories of construction equipment in the year 1982, compared with 1981. In the first quarter of 1982, unit shipments were down a staggering 56 percent in the construction equipment industry, compared with the first quarter of 1979, the last really strong year.

In terms of jobs, we have seen production worker employment in construction equipment plummet a staggering 33 percent between April of 1979 and April of 1982. In the farm equipment industry, production worker employment has dropped 47 percent. We are talking here about a combined loss of some 93,000 production-worker jobs. The heavy truck industry is in disastrous straits, with some 50 percent fewer unit shipments to date in 1982 than in the comparable months of 1979.

The repercussions have been catastrophic. If you look, for example, at the International Harvester Corp., they lost some $1.5 billion in the last 2½ years, and nearly went over the brink into bankruptcy. The fears have receded a bit in the last few weeks and months in the wake of top-management changes, but nevertheless, at this point in time, one-half of that corporation's 35,000 U.S. employees are laid off.

In aircraft industry—another UAW-organized industry—we have been hit, as Mr. Schechter described earlier, by the squeeze between recession and tight money that has affected the airlines, and we are not enjoying very good job prospects there.

So, in conclusion, Mr. Chairman, it is clear that monetarism has been a disaster for our economy and especially for workers who have been its chief victims.

It is a major cause of the economic slump. It has been one of the leading factors that has propelled much of America's basic industry, quite literally to its knees.

Obviously, we hope for an economic recovery, but in point of fact, there is substantial risk of continued economic calamity. Even if we have recovery, there is great fear that it will be nipped in the bud by high interest rates and tight monetary policy. Instead of monetarism, we need adequate credit, affordable interest rates, and in connection with achieving that objective, credit controls are an important tool to channel credit to productive uses.

We urge enactment of H.R. 6124.

Thank you, Mr. Chairman.

[Mr. Friedman's prepared statement, on behalf of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America, follows:]

STATEMENT OF
SHELDON FRIEDMAN, RESEARCH DIRECTOR, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA
ON
EXTENDING THE CREDIT CONTROL ACT
BEFORE THE
HOUSE SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE

July 14, 1982

Thank you for this opportunity to present the UAW's views on credit controls and monetary policy.

The UAW supports H.R. 6124, which would reestablish the stand-by authority to restrict credit granted to the President by the Credit Control Act of 1969. We also agree with strengthening the Act by including high unemployment and recession (in addition to inflation) as possible "triggers" to credit controls, prescribing limitations to credit for nonproductive purposes, and channeling credit to productive uses.

Pursuit of monetarism by the Federal Reserve Board during the last three years has perhaps been the most significant factor in propelling the country into its worst recession in 40 years. If continued, these policies of tight money and their sequel of ruinous high interest rates will straightjacket the economy. Prosperity cannot return unless monetarism is abandoned and growth and employment replace disinflation as goals of monetary policy. Presidential authority to establish credit controls and direct the Federal Reserve Board to allocate credit so that key but financially starved sectors are stimulated and speculative ventures are discouraged is essential to a flexible and responsive monetary policy.

The recession is taking its grim toll on many groups, but American workers are paying the steepest price: the number of jobless, discouraged, and underemployed have reached post-Depression highs. As of last count, 17.4 million people — or 15.6 percent of the country's potential labor force — were unable to find full-time work. Millions of those holding a job are fearful of what the future holds.

Not only has monetarism extracted a terrible price; its impact has been most unfairly and burdensomely distributed. Sectors of the economy most sensitive to credit market conditions have borne the brunt of the monetarists' assault. In particular, the auto industry and its suppliers have been in a depression for well over three years. While soaring imports and an uncertain energy outlook have been important factors in this mammoth industrial catastrophe, much of the responsibility for it rests with tight monetary policies and unprecedentedly high interest rates.

Recent evidence underscores the sensitivity of auto sales to interest rates. Starting last April 1, the General Motors Corporation offered to finance new car and truck purchases at 12.8 percent. Sales of GM cars, which in March had slumped 20 percent from the same month in 1981, chalked up a 7 percent increase in the last 20 days of April followed by a hefty 22 percent in May with respect to the comparable periods a year earlier. When the sales incentive program expired at the end of May, sales in June went back to a 17 percent decline relative to 1981. Further evidence of interest rate sensitivity is furnished by the University of Michigan survey of consumers: one-third of all households reported postponing purchases, chiefly homes and autos, because of high interest rates. Those families indicated that the highest rate they would be willing to pay for credit was 12 percent, several points below the current average finance rate for auto credit.

Compared with the first half of 1979, the industry's last healthy period, first half 1982 sales of domestic cars and trucks were down 34 percent. And the crisis shows no signs of abating:

- Relative to the same (depressed) period in 1981, 1982 domestic car and truck sales through June fell 5 percent;
- Production in the first half of 1982 barely exceeded 2.6 million cars, down [illegible] percent from 1981's low level;

- The mid June domestic car sales rate of 4.1 million (seasonally adjusted, annualized) is the lowest of the current recession.

In terms of jobs, the statistics are staggering:

- At the car assembly companies alone, more than three years after the current crisis began, over 220,000 workers are on indefinite layoff;
- Production worker employment in the motor vehicle industry, according to the Bureau of Labor Statistics (BLS), has declined by almost one-third since July 1979;
- Including the loss of supplier and other auto-related manufacturing jobs, the decline in employment has exceeded one million.

Basic metalworking industries outside of auto which employ large numbers of UAW members have also been dealt a terrible blow by the Fed's iron fist. As potential buyers of heavy machinery and equipment have lost access to credit, or have been able to obtain it only at exorbitant rates, sales and employment in these industries have been pummeled. And with worsening business conditions, most customary buyers of such equipment have increasingly found that they have more than ample capacity to handle their shrunken volume of business. Yet another perverse offshoot of high interest rates has been the allocation of money -- by Corporations which still enjoy some liquidity -- away from productive investments and into short-term instruments such as money market funds and certificates of deposits.

Sales of construction machinery equipment, which UAW members build, have been devastated by the slump in construction: unit shipments were down 56 percent in the first quarter of 1982 from the first quarter of 1979. Employment has dropped apace: more than 30,000 workers — over one-fourth of the total workforce — have lost their jobs. The demand for farm equipment has plummeted. Unit shipments fell 50 percent from the first quarter of 1979 to the first quarter of 1982, putting 38,500 workers (34 percent of the workforce) on the street. Sales of medium and heavy trucks in the first quarter of 1982 were over 50 percent lower than in the same period 3 years ago. The manufacture of commercial aircraft — another industry where thousands of our members work — has also been hit, due to the plight of major airlines caught in the squeeze between recession and tight money.

Beyond the direct impact of tight money, to the extent that high interest rates contributed to an unwarranted, surge in the value of the dollar, there has been a further depressing effect on domestic industries as imports have been stimulated and U.S. exports have become less competitive in world markets.

The crisis is placing an unprecedented strain on corporate finances throughout much of American industry. Since 1980, and including the first quarter of 1982, the four domestic auto companies have sustained a combined loss of $5.6 billion. A look into other UAW-organized industries reveals the situation to be just as serious. International Harvester, a leading manufacturer of heavy duty trucks and farm machinery, has lost $1.5 billion in the 2½ years ended last April, triggering fears of bankruptcy. Although those fears have receded somewhat in the wake of top management changes, the future of the company, its 35,000 employees (about half of whom are now laid off) and 20,000 retirees heavily depends on an improved economy and stronger sales — both of which are in turn endangered by high interest rates.

Countless parts supplier companies have also found themselves deeply in the red. Especially among small to medium-sized companies, many are teetering on the brink of bankruptcy. For them, the downward spiral of falling sales, greater indebtedness, and soaring interest payments often ends abruptly as banks refuse to finance them any longer. Thousands of UAW members have lost their jobs as these smaller plants have gone under.

Auto dealers, clobbered by high interest rates on two fronts — the financing of their inventory and consumer resistance — have closed their doors at an unprecedented rate. Between January 1979 and April 1982, 3,653 dealerships — over 15 percent of the end 1978 total — went out of business.

Weak sales, excess capacity — 30 percent in manufacturing and almost 45 percent in motor vehicles — low profits or outright losses, and the forbiddingly high cost of credit threaten to permanently damage auto and other basic manufacturing industries. Despite last summer's massive tax cut, a recent official survey reported a 2.4 percent real drop in 1982 spending on plant and equipment. The motor vehicle sector, which in the fourth quarter of 1981 announced plans to spend $12.2 billion in new investment in the first half of 1982, by late April had scaled that back to $9.2 billion and was planning a further drop, to $8.2 billion, for the second half of the year. As their investment plans are postponed or permanently scaled back, the future competitiveness of American basic industry is at stake — and so are the hundreds of thousands of jobs it provides.

Indeed, a stagnant economy, rising joblessness, and snowballing bankruptcies may only be followed by sluggish productivity growth, more stagnation, and increasing risk of even worse economic catastrophe. This frightening situation must be turned around, and turned around fast. Though it will not by itself be sufficient to turn the economy around, monetary policy holds a vital key to a strong and lasting upturn — through lower interest rates and adequate credit availability.

Credit controls, if properly implemented, can be a valuable and viable supplementary tool to bring credit within the reach of the nation's beleaguered manufacturers. In part, that would be done by curbing the diversion of funds to nonproductive uses such as those corporate takeovers or mergers which serve no useful public purpose, and financing of speculation. In addition, the Federal Reserve could be directed to make special efforts to maintain affordable credit flows for home buyers, car buyers, farmers, and for those activities that are closely tied to our flagging industrial base.

In conclusion, monetarism has been a disaster for the American economy and for the millions of working people who are its chief victims. It is the major cause of the worst recession since the Great Depression, and has contributed significantly to bringing much of America's basic industry, including auto, quite literally to its knees. Though hope springs eternal that recovery is imminent, the risk that even more serious economic trouble looms ahead cannot be discounted. Even if recovery comes, continuation of monetarism and sky-high interest rates threaten to nip it in the bud.

While there is no easy cure for our economic ills, the nation's monetary authorities must turn their attention away from monetarism and toward providing adequate credit at affordable interest rates so the economy can once again expand and grow. In achieving this aim, credit control authority of the kind provided in H.R. 6124 is an important policy tool. The UAW urges enactment of this vital legislation.

Thank you.

* * *

Chairman ANNUNZIO. Thank you, Mr. Friedman, for an excellent statement.

Thank you for bringing before the subcommittee all of the other industries that are affected by this disaster that we find ourselves in today.

Our next witness is also a former Chicagoan. He is the executive vice president of the National Association of Home Builders, and, Mr. Stahl, I would ask you, when you lived in Chicago, where did you live?

Mr. STAHL. I lived in the 39th Ward and in the 11th Congressional District.

Chairman ANNUNZIO. I wanted you to say that.

You may proceed in your own manner.

STATEMENT OF DAVE STAHL, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. STAHL. My name is Dave Stahl. I am executive vice president of the National Association of Home Builders.

I have been away from that great town of Chicago for 9 years, but it is always a pleasure to be with people from my hometown.

NAHB is a trade association of the Nation's homebuilding industry. I speak today representing the more than 111,000 members of NAHB, consisting of homebuilders, subcontractors, suppliers and many other facets of the homebuilding industry.

I would like to congratulate the chairman of this subcommittee for holding these timely hearings on whether to continue the standby Presidential authority to impose credit controls. With interest rates continuing at record high levels, all potential methods of dealing with inflation and interest rates should be carefully examined.

Mr. Chairman, it is customary for our association, in testimony before the Congress, to present the facts and figures relating to the state of our industry. At the beginning of this year, I had hoped that by July 1982, the description of the homebuilding industry would have included some optimism and signs of recovery. Tragically, this is not the case. The numbers in my prepared statement show the stark reality of a continued housing depression.

Your remarks, Mr. Chairman, and those of Chairman St Germain, and those of Congressman Weaver, summarize the state of our industry as well as anything I could say, and I will skip over all those numbers.

The numbers paint a bleak picture for the homebuilding industry. But today, every other business dependent on affordable credit for survival has a similar story.

NAHB supports H.R. 6124, introduced by Representative St Germain, chairman of the Banking Committee, which would extend the Credit Control Act and improve the President's ability to deal with high interest rates and unemployment. As an industry that has been the continued victim of high interest rates, we cannot, in good conscience, reject any standby Presidential authority to deal with this problem.

As the members of this subcommittee are well aware, we fought long and hard this year for an emergency housing and employment stimulus program to revive our industry and to generate an overall economic recovery. We believe this stimulation is an appropriate role for the Government.

One of the principal arguments used by opponents of the emergency housing program was that it was unnecessary, since the overall budget would reduce interest rates. But what happened once the budget passed? Interest rates began an upward climb, and political leaders and economists admitted the budget really would not bring down interest rates.

Furthermore, the administration is now indicating that the recession may have bottomed out and a recovery could be in the works. But according to several economists, this recovery won't include the housing industry or others dependent on affordable credit, as all recoveries have in the past.

Although the administration's midyear economic forecast calls for a resumption of economic growth, many private economists expect a continued recession. The reason given by the private economists is the continuation of high interest rates. Long-term interest rates, on which our industry is dependent, are not expected to drop this year. In fact, conventional mortgage rates have increased from 15.4 percent to 17.3 percent in the last 6 months.

What this means for the homebuilders that helped build up this Nation's economy, is that there won't be an economic recovery this year. What this means for potential home buyers is that there will be no light at the end of the tunnel this year.

From my discussions with homebuilders and potential home buyers alike, I find a serious lack of confidence concerning the future of our economy. People are worried whether they will be the next victim of unemployment and whether they can continue to pay their bills. The last thing someone is going to do with concerns such as these is make the largest single purchase of a lifetime, such as a new home. With nearly 10 percent of our workforce unemployed, and expectations such as these, a full economic recovery cannot and will not occur.

Those who argue against credit controls as interference in the credit markets ignore or are unconcerned with the difficulties that small businesses and consumers have in competing in the credit markets. The big borrowers, and the Federal Government is the biggest, continue to pay high interest rates regardless of their cost or impact on their budgets.

Corporations are able to tie up billions of dollars in loan commitments, which may never be used or are used simply to acquire another corporation. At the same time, the small borrower, who simply cannot afford to pay the market interest rates, is squeezed out of the market and ultimately out of business.

A monetary or credit policy which allows large businesses easy access to credit markets but at the same time chokes off the financing available for interest-sensitive small businesses, is neither equitable nor efficient. The system concentrates credit on those areas which contribute least to productivity. It is a system which rewards borrowers who are big and punishes those who are small.

H.R. 6214 would "prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers and otherwise insure the availability of credit for productive and necessary purposes." With this authority, the administration could still pursue a restrictive monetary policy but could encourage job creation, productivity, and the provision of needed housing by redirecting credit away from nonproductive uses.

Those who oppose credit controls usually argue that the free market is the appropriate and best mechanism for allocating credit. We disagree with this viewpoint and suggest that in times of recession, the President and the Federal Reserve Board can and should make value judgments about what is important and what is less important or of no importance to this society.

If owners of casinos, abortion clinics, and massage parlors can afford to pay 25 percent for mortgage money, we don't think the American homeowners should be cut out of the market because they cannot afford to compete with these and other questionable uses.

The whole Federal budget is a collection of value judgments about what is important to this society and what is less important or not important at all to this society. There are times when the Government can and should intervene in the private granting of credit to make similar value judgments.

This legislation correctly reserves these standby powers for the President alone. We believe the President must make the final decision to implement such powers. The legislation also requires the President to work with the Federal Reserve in implementing any credit controls. I would hope this would assure that extensive communication between the President and the Chairman of the Fed occurred before any controls were activated. These past 2 years have been a good indication that much more cooperation is needed between our fiscal and monetary policymakers.

In light of the continued levels of high interest rates which are preventing a full economic recovery and the seeming inability of Government and business to reduce rates, the standby powers embodied in H.R. 6124 may be the only short-term approach to reducing high interest rates. A continued wait for a long-term recovery will guarantee further bankruptcies, unemployment, and widening budget deficits.

I urge this subcommittee and the entire Congress to act to extend the Credit Control Act with the added flexibility embodied in H.R. 6124 to allow the President the standby authority to deal promptly with high interest rates. I thank you for the opportunity to present our views on this subject, and would be happy to answer any questions.

Let me pick up on another point which has already been made here today.

I had the privilege in May to attend my son's graduation from Annapolis from the U.S. Naval Academy.

Secretary Weinberger spoke to this graduating class and made a really articulate and inspiring charge to these young officers about their role in preserving the peace all over the world. But, of course, Secretary Weinberger wants more tanks, aircraft carriers, and missiles to keep this peace.

My son is down in Pensacola, Fla., learning to fly jets. I hope he does not have to use these weapons he is learning about, but if he does, I want him to have the best tools available in the world.

The President should have the best tools available to deal with the economy. Credit controls are one of these tools.

Thank you for inviting me to be here.

[Mr. Stahl's prepared statement, on behalf of the National Association of Home Builders, follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

ON

EXTENSION OF THE CREDIT CONTROL ACT
JULY 14, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Dave Stahl, and I am Executive Vice President of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry. I speak today representing the more than 111,000 members of NAHB, consisting of homebuilders, subcontractors, suppliers and many other facets of the homebuilding industry. Accompanying me today are Jim Schuyler, Staff Vice President and Legislative Counsel and Joe McGuire, Director of Regulatory Affairs.

I would like to congratulate the Chairman of this Subcommittee for holding these timely hearings on whether to continue the standby Presidential authority to impose credit controls. With interest rates continuing at record high levels, all potential methods of dealing with inflation and interest rates should be carefully examined.

Mr. Chairman, it is customary for our association in testimony before the Congress to present the facts and figures relating to the state of our industry. At the beginning of this year, I had hoped that by July 1982, the description of the homebuilding industry would have included some optimism and signs of recovery. Sadly, this is not the case. The numbers in my prepared statement show the stark reality of a continued housing depression.

HOUSING PRODUCTION

- New housing production in 1981 totalled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980s. Last year was the worst housing production year since 1946.

- 1982 could finish as the worst post-war production year yet. NAHB's optimistic forecast for this year anticipates annual production of 1.1 million. Housing starts in May were at a seasonally adjusted rate of 1.006 million down 7 percent from a year earlier, and down more than 4[illegible] percent from the peak of over 2 million in 1978.

- May is the 43rd month of recession in housing. The previous record was set during the Eisenhower Administration when a housing recession lasted 27 months.

NEW HOME SALES

- 1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 436,000 new homes were sold, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.

- Since March 1981, annual new home sales rates has been under the 400,000 level for 9 of the past 10 months. In May of this year, the annual sales rate of new homes was [illegible], which is 19 percent below the May 1981 sales rate.

- Actual sales rates in May nationwide were 36,000 new homes--roughly the monthly number of new homes that were sold in the South alone during 1978. In all of the western states, only 8,000 new homes were actually sold in May. Only 8,000 new homes were sold in the Northeast and North Central states combined.

AVAILABLE

INTEREST RATES

- Conventional mortgage interest rates still average above 17 percent. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.
- Interest rates normally fall rapidly and decisively during recessions, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15 percent this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depressed levels until mortgage rates drop to the 14 percent range, which by historical standards still represents an extraordinary high cost of home financing.
- By reducing interest rates from 16 percent to 12 percent, 4.6 million additional families could qualify for a $65,000 mortgage. At 12 percent interest rates, more than 22 percent of the nation's families have the $35,000 income needed to quality for a modest $65,000 mortgage. At 16 percent rates, fewer than 14 percent have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

- Unemployment in the construction trades in June was 19.2 percent or 963,000 unemployed workers, accounting for one out of every ten unemployed members of the work force. Another 200,000 skilled craftsmen could lose their jobs over the next several months.
- An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.
- Bankruptcies are up 51 percent for construction firms and 68 percent for subcontractors.
- Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1 percent increase in unemployment costs the Treasury $25 billion -- $19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

Mr. Chairman, these figures paint a bleak picture for the homebuilding industry. But today, every other business dependent on affordable credit for survival has a similar story. NAHB supports H.R. 6124, introduced by Rep. St Germain (D-RI), Chairman of the Banking Committee, which would extend the Credit Control Act and improve the President's ability to deal with high interest rates and unemployment. S. 2526, a similar bill, has been introduced in the Senate by Senator Cranston (D-CA). As an industry that has been the continued victim of high interest rates, we cannot, in good conscience, reject any standby Presidential authority to deal with this problem.

As the members of this Subcommittee are well aware, we fought long and hard this year for an emergency housing and employment stimulus program to revive our industry and to generate an overall economic recovery. Although both Houses of Congress overwhelmingly agreed with the need for such a program, support was not great enough to override the President's veto. In the aftermath of this legislative battle, we have asked ourselves, what can the Congress and the Administration do to lower interest rates and generate an economic recovery?

One of the principle arguments used by opponents of the emergency housing program was that it was unnecessary, since the overall budget would reduce interest rates. But what happened once the budget passed? Interest rates began an upward climb, and political leaders and economists admitted the budget really wouldn't bring down interest rates.

Furthermore, the Administration is now indicating that the recession may have bottomed out and a recovery could be in the work. But according to several economists, this recovery won't include the housing industry or others dependent on affordable credit. Although the Administration's mid-year economic forecast calls for a resumption of economic growth, many private economists expect a continued recession. The reason given by the private economists is the continuation of high interest rates. Long term interest rates, on which our industry is dependent, are not expected to drop this year.

What this means for the homebuilders that helped build up this nation's economy, is that there won't be an economic recovery this year. What this means for potential homebuyers is that there will be no light at the end of the tunnel this year. From my discussions with homebuilders and potential homebuyers alike, I find a general lack of confidence concerning the future of our economy. People are worried whether they will be the next victim of unemployment and whether they can continue to pay their bills. The last thing someone is going to do with concerns such as these is make the largest single purchase of a lifetime, such as a new home. With nearly 10 percent of our work force unemployed, and expectations such as these, a full economic recovery can not and will not occur.

H.R. 6124 retains for the President standby powers to deal promptly and decisively with high interest rates and inflation when other options have failed. In light of current economic conditions and the outlook for interest rates, some sort of a credit policy may be the only option available for reducing interest rates and stimulating economic activity. This legislation also would allow the President acting through the Federal Reserve Board to use this authority to limit non-productive uses of credit.

Those who argue against credit controls as interference in the credit markets ignore or are unconcerned with the difficulties that small businesses and consumers have in competing in the credit markets. The big borrowers, and the federal government is the biggest, continue to pay high interest rates regardless of their cost or impact on their budgets. Corporations are able to tie up billions of dollars in loan commitments, which may never be used or used simply to acquire another corporation. At the same time, the small borrower, who simply cannot afford to pay the "market interest rates," is squeezed out of the market and ultimately out of business. A monetary or credit policy which allows large businesses easy access to credit markets but at the same time chokes off the financing available for interest sensitive small businesses is neither equitable nor efficient. The system concentrates credit on those areas which contribute least to productivity. It is a system which rewards borrowers who are big and punishes those who are small.

H.R. 6124 would "prescribe limitations with respect to credit for non-productive purposes, including corporate takeovers and otherwise ensure the availability of credit for productive and necessary purposes." With this authority, the Administration could still pursue a restrictive monetary policy but could encourage job creation, productivity and the provision of needed housing by redirecting credit away from non-productive uses.

Those who oppose credit controls usually argue that the free market is the appropriate and best mechanism for allocating credit. We disagree with this viewpoint and suggest that in times of recession, the President and the Federal Reserve Board can and should make value judgements about what is important and what is less important or of no importance to this society. If owners of casinos, abortion clinics and massage parlors can afford to pay 25 percent for mortgage money, we don't think the American homeowners should be cut out of the market because they can't afford to compete with these and other questionable uses. The whole federal budget is a collection of value judgements about what is important to this society and what is less important or not important at all to this society. There are times when the Government can and should intervene in the private granting of credit to make similar value judgements.

The authority granted the President under the recently expired Credit Control Act of 1969 allows the President, acting through the FED "to regulate any or all extensions of credit in order to prevent or control inflation caused by excessive volumes of credit in the economy." H.R. 6124 would retain those powers but also expand the President's flexibility to deal with high interest rates. The proposed legislation would give the President more authority to reduce high levels of unemployment in any sector of the economy, and to mitigate the impact of recessions.

This legislation correctly reserves these standby powers for the President alone. We believe the President must make the final decision to implement such powers. The legislation also requires the President to work with the Federal Reserve in implementing any credit controls. I would hope this would assure that extensive communication between the President and the Chairman of the FED occured before any controls were activated. These past two years have been a good indication that much more cooperation is needed between our fiscal and monetary policy makers.

In light of the continued levels of high interest rates which are preventing a full economic recovery and the seeming inability of government and business to reduce rates, the standby powers embodied in H.R. 6124 may be the only short term approach to reducing high interest rates. A continued wait for a long term recovery will guarantee further bankruptcies, unemployment and widening budget deficits.

I urge this Subcommittee and the entire Congress to act to extend the Credit Control Act with the added flexibility embodied in H.R. 6124 to allow the President the standby authority to deal promptly with high interest rates. I thank you for the opportunity to present our views on this subject, and would be happy to answer any questions.

Chairman ANNUNZIO. Thank you very much, Dave. Your statement is excellent. I couldn't agree with you more on your last statement.

I have been accused of being a supporter of the military versus social programs, and so forth and so on, but you must remember that when you have people like your son, who is in the armed services, that you are trying to give them the very best to defend and protect themselves and defend this Nation, and I see nothing wrong—I just can't understand what some of these people are thinking about, to have the necessary tools and weapons available so that if our domestic economy is in trouble, we can do something about straightening it out, and this is one of the things that has been lacking. They had it until June 30 of this year but did not see fit to use it. That is no reason that the Congress should allow the Credit Control Act to die completely.

Mr. Schechter, I have one question for you.

Last week, the Penn Square National Bank failed, creating losses of thousands, billions of dollars, of many banks, credit unions, other uninsured depositors who sought the high interest rates offered by Penn Square.

After Penn Square failed, you see—there is a new term now that has come into our vernacular, after we got through with the decontrol bill, the money market funds, and all of a sudden there is $200 billion of funds, and money has been drained out of the S. & L.'s, commercial banks.

I want you to tell us about these money brokers they are talking about, for the record.

What is their function?

Mr. SCHECHTER. Their function seems to have been to obtain funds, induce other banks and credit unions, and so on, to keep Penn Square afloat. They are getting——

Chairman ANNUNZIO. Does Penn Square hire these money brokers because they need all this money, so the money brokers go out to the others?

Mr. SCHECHTER. There is a deeper influence here.

When we allow interest rates to go up high, the institutions themselves have to begin to pay high interest rates to get the funds—this happened in the late 1920's—and therefore, they have to reach. Even if it does not look like a very sound deal, as the bankers put it, they are always looking for a sound loan, but if they are paying 15 percent to get money, of course, they are going to look for something that may even be a little bit shaky as long as it will pay them 17 or 18 percent, and this is what we have happening.

It happened with Drysdale Securities not long ago. It is happening with Penn Square. The Continental Bank of Chicago got hit for about a billion dollars.

All this talk about leaving the financial community to operate in a free market, they are only human beings. They are subject to certain enticements, to make a buck fast, to take a chance.

That is why, if I can go back in history a moment, after the Great Depression, when we had a lot of trouble because of such lending policies, we got the Glass-Steagall Act, which put clamps on them.

After the shake-out following the war, we had about 10 years during the 1950's, practically no bank failures, no mergers needed, so the bankers started coming to you people in Congress and said, look, we are doing a fine job. We don't need all these laws to tell us how to run our business.

Gradually they got more and more freedom. Under the Reagan administration, they have the utmost freedom. Penn Square was not the first failure, so we are back where we were in the late 1920's, early 1930's, with the banking business.

Chairman ANNUNZIO. In other words, when I go to a bank and make a loan or you go or Dave Stahl, they tell you, they say, well, what about your collateral?

Well, we have got to have collateral coming out of our ears before we get money.

Here is a loan portfolio. Penn Square has a loan portfolio, they go to a money broker. They go to this money broker, the money broker just sells the amount of money that Penn Square needs.

They don't care about what is in that portfolio, as far as collateral, whether it is a good loan or a bad loan. They are only interested in the brokerage that they collect?

Mr. SCHECHTER. That sums it up, Mr. Chairman, yes.

Chairman ANNUNZIO. That is the new gimmick since we have gone into this disastrous money situation and high interest rates in this country and even seeking high interest rates has brought about the rise now of money market funds, and now we have another term known as money brokers.

Mr. SCHECHTER. Yes, and if I can add, one of the things that makes it worse is because of the fact that most money is being loaned from one step to another short term, and the bankers now have floating rate loans like the variable-rate mortgage, they think they are safe because they are shifting the risk of an interest rate change to the borrower, but actually they are creating a bigger risk for themselves, because with enough of these things, the whole system begins to fall apart.

Chairman ANNUNZIO. Mr. Prins.

Mr. PRINS. I went to school in your section of the country, so I am a little bit familiar with this.

I would like to ask a question and paraphrase it by a little story, and see if maybe this is not true, that we really do have credit allocation in this country.

It is just that the credit allocation is not decided by perhaps the people that we would want to decide it.

The story is this, it is about a farmer who goes into a banker to get a loan, and he goes in and he wants to borrow $4,000, small farmer. The banker says, "What kind of collateral do you have for the loan?"

The farmer says, "Well, I have an old broken-down plow, a one-eyed mule, and I have some old seed back there that I will put up as collateral."

Well, the banker does not want to make the loan, so he comes up with a story to the farmer, he says, "Well, gee, you read the newspapers, Sam, you know that money is scarce. The Federal Reserve is restricting credit, raising interest rates. Money is really, really scarce right now.

"I would love to make you the loan. I really would, Sam, but I can't make the loan because money is scarce."

The farmer thinks for a minute and says, "Well, Mr. Banker, if I had a $4 million farm to put up as collateral for that loan, would you make me the loan?"

The banker smiled and said, "Sam, if you had that kind of collateral, I'd make the loan in a second."

The farmer said, "Well, look, it is not money that is scarce, it is collateral that is scarce."

It is the golden rule right now. We don't have any scarcity of money in this country. We have a scarcity of people getting the money who need the money. If you could pay the price, you could get the money.

Would the whole panel agree with that?

Mr. SCHECHTER. At a price, you can usually get the money, at all times.

Mr. PRINS. Thank you, Mr. Chairman.

Chairman ANNUNZIO. Mr. Friedman, the automobile industry, as you and I know, I was part of the panel that went all around the country, it is in disastrous shape.

If interest rates don't come down, in your judgment, how much worse can this situation get?

Mr. FRIEDMAN. It is hard to imagine it getting worse than it is. The conditions are absolutely without precedent since the Great Depression in the auto industry. We have a sales level that we haven't seen in 20 or 25 years.

Chairman ANNUNZIO. It can get worse if the interest rates don't come down?

Mr. FRIEDMAN. It can't get any better, if they stay so high.

Chairman Annunzio. In the last Depression, we didn't have an automobile industry that amounted to anything, so we have had nothing to go by. You follow me?

Mr. Friedman. Right. If you look back 20 years ago and say the sales now are as low as they were then, that understates how bad things are, because 20 years ago, the country had maybe a third fewer inhabitants.

Chairman Annunzio. That is correct. That is absolutely correct, so we can't judge, don't you see?

Mr. Friedman. Yes.

Chairman Annunzio. I remember the last Depression. My family was a victim of the last Depression. On the block that I lived on, if there were three automobiles, there were three too many. That was a rarity.

As kids, we could skate on the streets and use our bicycles. In those days, we didn't have bicycles. We used to make our own pushmobiles, with the apple box and the 2x4, you see, but the problem, what I am trying to put across, we have no way of comparing this thing.

Today we have developed a great automobile industry in this country, employing some half million workers.

When you look back to 1929 and 1930, you only had 10,000 people employed in the automobile industry, so there is no way that Depression affected the automobile industry. But the automobile industry, once it grew in numbers and in strength and became the greatest producers of automobiles of any country in the world, for us to be flat on our back, and that is economically where we are, we are flat on our back, and I am wondering how much flatter they can flatten us out.

Mr. Friedman. I don't even like to think about that, Mr. Chairman.

Chairman Annunzio. We have to start thinking about these things or you are not going to move these Members of Congress who are living in a sheltered situation.

They are sheltered. They don't know what is going on in the real world.

Mr. Friedman. For 3 years, each year in succession, everyone thought the auto situation couldn't get any worse, only to be proved wrong. The only light at the end of the tunnel seems to be an oncoming freight train.

Chairman Annunzio. But you must admit that every year when you thought it couldn't get worse, it got worse.

Mr. Prins. I wonder if that light at the tunnel might be the rescuers searching for survivors?

Mr. Friedman. Yes, as the latest sales figures show, it is getting worse.

Chairman Annunzio. Mr. Stahl, home construction in 1982, it will set a postwar record low, how much of that decline in your judgment is accounted for by high interest rates and how much by other factors?

I have read in the papers that homebuilding made a slight increase but I would like for you to tell it for the record.

Mr. STAHL. When I was in Chicago, Mr. Chairman, and working on some model cities, antipoverty and human welfare programs, we used to talk about pockets of poverty.

I wish Congressman Paul was here. Houston is a pocket of prosperity.

It has 1 percent of the population of the United States, but 7½ percent of the total housing production in the United States right now. Houston is a beacon, a rare exception.

The rest of the country has been devastated and the greatest single cause is high interest rates.

The difference between 16 percent and 12 percent mortgage rates is that 4.6 million American families are priced out of the housing market.

I think increasingly, however, the length and depth of this recession is hurting the housing industry, and as I said in my testimony, people are having serious doubts about the future.

They are wondering if they will have a job next month or next year, and therefore, they are holding back from making a major commitment to a large capital good, like a house.

The impact of 43 months' decline in our industry is beginning to take it toll and function in concert with high interest rates to make things worse.

Chairman ANNUNZIO. There are elements in this country, and this is my last question, when we talk about homebuilding, they talk about the rise in the building costs. They talk about the labor costs, and those are the other factors that I was getting at.

Actually, the biggest cost contributing to the decline of the homebuilding industry has been interest rates, because when you build a house today, you must consider land costs.

Years ago, nobody ever talked about land costs. Land costs, the building material costs, the labor costs, and everybody is saying, well, labor is the big thing, and I am not here to defend labor, but the truth of it is that I am here to get the facts, that the labor costs have not risen as high as the building material costs and land costs.

Land costs have gone higher in proportion to the labor costs, so we have got to start putting all these elements together.

People have got to start working together, so that they understand, so that just because the makeup artist makes you look good, you know, you can't be sold that kind of a bill of goods. Mr. Stahl is absolutely right when he talks about pockets, just like when we passed that crime insurance bill. I had hearings all over the country, and the fair plan hearings, you know, there were pockets of people in the inner cities of America who could not afford insurance or buy insurance and it would have completely destroyed our cities if we had not gotten that kind of a program.

We should start using those insurance plans, crime insurance plans and some of the other great plans that have worked in this country to help people. This is what we are trying to do with the Credit Control Act.

We are trying to get things moving and trying to do something and it is going to be a long, long fight. I know all of you favor it. I have been in these fights, you know that.

I have the toughest subcommittee on the Hill. Anybody who is a friend of the consumer is a friend of no one, because the consumers praise you one day, and they complain the next day, so it is a tough job.

I want to express my deep appreciation to all of you for bearing with us. We are continuing the hearings tomorrow. We are continuing the hearings on Friday and I am going to try to markup this bill early next week so you can bring that back to the committee that called on me, Mr. Schechter. I hope we will be able to mark it up by Tuesday.

I thank you very much for your contributions.

The subcommittee stands adjourned until tomorrow at 10 o'clock.

[Whereupon, at 1:25 p.m., the subcommittee was adjourned, to reconvene at 10 a.m., Thursday, July 15, 1982.]

[The following questions were submitted to the witnesses by Congressman Paul and appear with the responses of the witnesses:]

Question 1. How do you define a "productive and necessary" use of credit as opposed to a "nonproductive" use of credit? Please be specific.

RESPONSE RECEIVED FROM MR. SCHECHTER

A "productive and necessary" use of credit would (a) add to capability within the economy to increase production or efficiency in production of goods and services traditionally provided through the private market and those traditionally provided through governments which are needed for the present and future health and welfare of the citizens or defense of the nation, and (b) enable the citizens that are in need of credit to purchase such goods and services, and financially qualified, to receive such credit. A "nonproductive" use is one which would not add to the capability within the economy to increase production or efficiency in production of goods and services needed for the present and future health and welfare of the citizens or defense of the nation.

RESPONSE RECEIVED FROM MR. FRIEDMAN

Productive and necessary uses of credit can be defined as those uses which further goals such as economic growth and full employment and which at the same time possess high social priority. Well-known examples of non-productive use of credit are many corporate takeovers and mergers, and speculative activity. At this juncture credit to car buyers, home buyers, and for investment in certain hardpressed industries which are key to reindustrialization and economic recovery are clear instances of productive credit use.

Question 2. What guidelines should the Committee consider for these definitions? Please be specific.

RESPONSE RECEIVED FROM MR. SCHECHTER

In addition to the considerations inherent in the definitions themselves, the Committee should consider as guidelines the numbers of people and enterprises that would be affected advantageously or adversely; the degree of deferability of certain credit-use activities versus the degree of hardships that might be caused by the need to defer such activities; and the effect of actions that might be taken toward providing relief from and counteracting prevailing conditions that are economically destabilizing (i.e., recession and/or inflation). A more general guideline would be to take into account the alternative cumulative snowballing effect of the destabilizing conditions if standby credit controls are not adopted temporarily and there is continued reliance only upon monetary policy, which during a tight-money, presumably anti-inflationary period means reliance upon a prolonged prevalence of high interest rates, and the accompanying damage that is caused.

RESPONSE RECEIVED FROM MR. FRIEDMAN

Guidelines that should be considered are: employment; social welfare; strengthening [illegible] regional balance and community stability; and increased [illegible].

[illegible] DOCUMENT AVAILABLE

[illegible] What are your priorities for determining who should receive credit [illegible] Federal Reserve has implemented this legislation?

RESPONSE RECEIVED FROM MR. SCHECHTER

[illegible] the abovementioned definitions and guidelines, some selective prefer[illegible] credit ceiling, should be shown for those sectors of the econo[illegible] to high interest rates and have a demonstrated role in [illegible] out of recessions. The preference areas would include [illegible] small business, and local government public works fi[illegible] credit for activities which do not contribute to produc[illegible] might temporarily be excluded. The latter category would [illegible] takeovers, excessive commodity speculation, and such [illegible] complexes and racetracks.

RESPONSE RECEIVED FROM MR. FRIEDMAN

[illegible] would clearly single out some industrial sectors for [illegible] treatment. For example, more credit at lower interest rates for [illegible] and purchases of other automotive equipment would go a long [illegible] the industry and the economy on a sustained basis. Curtail[illegible] coupled with an "easier" monetary policy, [illegible] credit at lower interest rates to the rest of the economy.

[illegible] How would you assess the Federal Reserve's performance during [illegible]

RESPONSE RECEIVED FROM MR. SCHECHTER

[illegible] rather than performance, are what the AFL-CIO [illegible] the past few years. More specifically, there has been too [illegible] tight money and high interest rates to "wring [illegible] price that workers, businesses, and local [illegible]

RESPONSE RECEIVED FROM MR. FRIEDMAN

[illegible] the Federal Reserve has focused on combatting infla[illegible] policy which, as the UAW warned all along [illegible]

[illegible] If the Federal Reserve's performance is less than satisfactory in [illegible] that same Federal Reserve the power to [illegible] credit in this country?

RESPONSE RECEIVED FROM MR. SCHECHTER

[illegible] the Federal Reserve in the implementation of credit controls [illegible] that had to be triggered by the President, was help[illegible] credit, although some selective preference was in[illegible] Federal Reserve to banks. There was some unintended [illegible] credit, which can be attributed to inexperience in [illegible] under the Credit Control Act.

RESPONSE RECEIVED FROM MR. FRIEDMAN

[illegible] would be established by H.R. 6121 the [illegible] for the Federal Reserve in con[illegible] should be coupled with [illegible] the Federal Reserve Board more account[illegible] responsive to the executive and legislative [illegible]

[illegible] to [illegible] the unem[illegible] percentage points [illegible] worse with such

RESPONSE RECEIVED FROM MR. [illegible]

[illegible] between December [illegible] March 14, [illegible] percent [illegible] of 1 percentage point from the low of 5.6 percent in July 1979. During those seven intervening months, both short-term and long-term interest rates had been rising sharply, while the seasonally adjusted annual rate of housing starts, industrial production, and the manufacturing capacity utilization rate were trending downward.

The recession was already in the making and gathering momentum before credit controls were placed in effect. A drop in unemployment is the result of developments of preceding months. That fact is most vividly illustrated by the rate of new housing unit starts which declined from a peak seasonally adjusted annual rate of 1,874,000 in September 1979 to 1,041,000 in March 1980, a 43 percent decline. Before new units are started, builders must have a mortgage commitment for a mortgage that will be closed and delivered to the lender six months to a year later after the house is completed and sold. Therefore, the decline in starts lags a month or two behind the rise in interest rates. The decline in construction employment lags a few months behind the decline in starts as workers are still employed finishing residential structures that were started six to twelve months earlier. These effects, shown on the attached table, indicate how the unemployment effects experienced during the credit control period were related to prior rises in interest rates that reduced economic activity. They also show how a decline in interest rates, resulting from the March-July credit controls, led to a pick up in housing starts and construction activity that cut the 1980 recession short and led to a prosperous second half.

Month	National average commitment interest rate on conventional home loan with 75 percent loan to price ratio ¹ (percent)	Seasonally adjusted annual rate of new private housing unit starts ² (thousands)	Construction unemployment ³	
			Percent rate	Number of workers (thousands)
[illegible]	11.69	1,874	9.2	583
[illegible]	11.34	1,710	10.0	541
[illegible]	12.33	1,522	10.5	572
[illegible]	12.67	1,548	11.2	614
[illegible]				
[illegible]	12.76	1,419	11.7	630
[illegible]	12.87	1,330	11.3	601
[illegible]	14.26	1,041	13.1	697
[illegible]	16.36	1,030	14.6	759
[illegible]	15.28	906	16.4	869
[illegible]	[illegible]	1,223	15.7	850
[illegible]	12.25	1,265	15.8	817
[illegible]	12.19	1,429	16.7	867
[illegible]	[illegible]	1,541	15.8	814
[illegible]	13.39	1,557	14.2	744
[illegible]	13.88	1,563	14.5	767
[illegible]	[illegible]	1,548	13.8	711

[illegible]

Response Received From Mr. Friedman

Use of credit controls in the present situation could reduce unemployment by channeling funds at reasonable rates to sectors, such as auto, construction, and agriculture, which have been clobbered by high interest rates and recession. However, use of credit controls does not preclude the need for other antirecessionary measures such as public employment programs and public investment, and longer range stabilization policies.

Question 6. H.R. 6123 authorizes the President to invoke the Credit Control Act at virtually any time. That Act grants the Federal Reserve the authority to "prescribe appropriate requirements . . . as the form, contents, or substantive provisions of contracts . . . ." I read this to mean that the Federal Reserve could suspend all existing credit contracts or require them to be renegotiated to meet the contents and provisions the Federal Reserve desires. How does your association feel about granting this kind of authority to the Federal Reserve?

in ten Operating Engineers are searching, in vain, for a place to apply their skills. In much of Massachusetts, the unemployment rate among our members is 77 percent. In Portland, Oregon, the figure is 61 percent, and in Rochester, New York, 85 percent.

I could continue this recitation of numbers across much of the land. But the point is that these figures translate into monumental suffering -- not only for Operating Engineers and their families, but for more than a million skilled Americans in the construction industry who want desparately to work but are being denied the opportunity.

Construction workers are not alone among those being cut down by the sword of high interest rates.

It is in recognition of this fact that unions welcomed the formation of the National Council for Low Interest Rates.

The Council membership is as diverse as the problem is broad. We are concerned with every aspect of the multiple injuries being inflicted by high interest rates.

Small businesses, for example, are being forced into bankruptcy at a rate not equalled since 1933, at the depth of the Great Depression. They are being devoured by the inability to function under conditions in which as much as one dollar in every four is consumed by high interest rates. During the six months ended July 1, 1982 - 11,948 businesses failed. That's an increase of [illegible] percent over the 1981 failure rate, and equal to the number of business bankruptcies recorded during the full year of 1980.

Each of those bankruptcies represents a multiple loss of jobs, and a further weakening of our general economy.

For businesses, and particulary small businesses, high interest rates have taken on a self sustaining quality. Many of those who operate businesses are being forced to borrow money in order to pay the interest on their old loans. This practice represents a Catch 22 that can lead only to failure.

Many of the members of this Committee are fully aware of the desperation that high interest rates is sowing among our country's farmers. Thousands have been placed in the position where they can no longer borrow the money they must have to prepare their fields and plant their crops. All that remains for these victims is a slow economic collapse.

Mr. Chairman, it is difficult to overstate the tragic cost being extracted from our farmers by high interest rates. The outstanding debt of farmers in 1981 rose by 15 billion dollars to a staggering $195 billion dollars. Farmers paid out more to service this mountain of debt than they received in net income.

While farm debt has been soaring, farm asssets have become frozen at a trillion dollars. Indeed, the market value of farm land -- the basic collateral for loans -- dropped by a full percent between February of 1981 until April of this year.

These catastrophic circumstances are placing more and more of our farmers in a vise from which their only escape is liquidation and bankruptcy.

The plight of our housing industry, which has become the heartbreak of untold numbers of Americans wanting to fulfill their dream of becoming homeowners, is being reported on a regular basis. New housing starts in May, were still stumbling along at an annual rate of just 1.1 million.

Houses are not being built because they cannot be sold. They cannot be sold because of the outrageous mortgage interest rates, which exceed 17 percent. To put that figure in perspective, the cost of interest payments alone on a 17 percent mortgage will equal the amount being borrowed in less than five years.

Not only has this brought severe unemployment in the housing industry, it has savaged many directly related industries, including lumber, concrete and the entire real estate sales sector.

Another economic sink hole created by the quicksand of high interest rates is the auto industry. Others will testify in detail to the wholesale casualties suffered by our once dynamic, profitable and proud American auto industry. But for the record here, let it be noted that car sales, both domestic and foreign, during the first six months of this year were 10 percent below the depressed rate of a year ago. Sales last month were the lowest for any June in a quarter of a century.

Since the industry's last "normal" year -- 1978 -- domestic automobile production has tumbled 35 percent; truck production has dropped by 50 percent.

Again, buyers are stymied by the high interest rates demanded to finance the purchase of a new vehicle.

And again, workers are among the primary casualties. A quarter-million jobs have vanished from auto production plants, and three times as many from companies who supply the auto manufacturers.

Utilities, and particularly our electric utilities, are our economy's most capital intensive industry. Each dollar of annual revenue requires an investment of three to four dollars. Electric utilities alone require 15-to-20 billion dollars in new money each year.

High interest rates have not only disrupted the electric utilities financial market, they have imposed a heavy cost burden on consumers.

Nor is government, itself, exempt from the debilitating drain caused by high interest rates.

Government at all levels must pay the high interest rate penalty that our current economic policy is extracting.

The fastest growing item in the Federal budget is interest payments. This fiscal year alone, taxpayers will be forced to underwrite 115 billion dollars in interest payments -- an amount that may equal our Federal deficit. Next year, the Treasury tells us we can look forward to paying 132 billion dollars for interest, an amount more than sufficient to cover all of the painful cuts that have been made in programs serving our society's well being.

The interest being paid on the public debt has far outstripped the growth in the debt itself. Since 1954, the public debt has more than tripled, but the interest payments made to finance that debt have multiplied 12 times.

State and local governments have been afflicted by the toll of interest payments, as well. Interest costs for the average state and local security have doubled in their dollar amounts in the past five years.

Mr. Chairman, this is far from a complete list of the segments of American society that have been wounded by interest rates that are clearly out of control. From the steel industry to the little person who must borrow a few dollars quickly to meet an emergency, high interest rates have become a ransom demanded by our wrongheaded economic policy -- a ransom that is becoming increasingly beyond the ability of many to pay.

In order to bring down interest rates and maintain rates compatible with healthy economic growth, we strongly support Chairman St Germain's bill, H.R.6124, the "Low Interest Rate Act of 1982." Chairman St Germain's bill, along with its Senate companion introduced by Senator Alan Cranston, S.2526, extends and improves the Credit Control Act of 1969. We are convinced that use of the Credit Control Act offers the only avenue available for removing the crushing burden of high and volatile interest rates.

The Low Interest Rate Act extends the ability of the President to authorize the Federal Reserve Board to control credit. It improves the "trigger" for the use of that authority by including considerations of recession and unemployment -- the current products of our nation's monetary policy -- in addition to the original consideration of the Act for preventing or controlling inflation. There can be no doubt that these additional triggering criteria are appropriate in today's climate.

The St Germain bill further improves on the 1969 Act by explicitly authorizing the Federal Reserve Board to "ensure the availability of credit for productive and necessary purposes," specifically by prescribing "limitations with respect to credit for nonproductive purposes, including corporate takeovers."

Our coalition is deeply committed to each of these provisions of H.R.6124.

First, our Nation's one experience with credit controls under the 1969 Act -- for a brief period in the spring of 1980 -- indicates that they can work to bring interest rates down dramatically: in a matter of weeks after the imposition of controls the prime interest rate fell from 20 percent to 12 percent, and the decline in home construction and overall economic activity was actually reversed. I think we also learned some lessons from that experience about how not to apply selective credit regulations, particualarly in squeezing out consumer credit on what became in some cases a retroactive basis.

Foreign experience also indicates that selective credit measures can and do play a vital and successful role in helping maintain healthy economic growth consistent with holding the line on inflation. The Japanese financial system has for years functioned on the basis of "administered" interest rates, with targeting of capital flows to priority industrial developments. The Japanese results have certainly been successful, with low inflation and unemployment coupled with strong productivity growth and industrial investment, and an exchange rate (largely caused by the gap between Japan's low interest rates and record high interest rates in other industrial countries) conducive to strong international competitiveness. The converse example is provided by Great Britain which, under Margaret Thatcher's Conservative government, has pursued a monetarist policy similar to that of our own Federal Reserve Board. The results in Britain have been similar to those in the United States: recession and high unemployment coupled with falling industrial investment and, subsequently, falling productivity. Their international competitiveness, like ours, has suffered from the undermining of new investment by high interest rates and by the overvaluation of their currency stemming in large part from their very high interest rates.

The members of our coalition, as we mentioned earlier, are convinced that there is no practical alternative to selective credit controls as a means of lowering interest rates. Lowering interest rates and maintaining them at reasonable levels are in turn necessary for economic recovery from what has become the deepest recession since the 1930s -- a recession caused and now perpetuated by high interest rates.

The present economic conditions in this country and the persistence of very high interest rates -- and record "real" interest rates --are far from normal. It is precisely the abnormal nature of our present circumstances that make credit controls necessary for bringing rates down and holding them down. First, our country is experiencing a record boom of corporate mergers which are soaking up unprecedented tens of billions of dollars of loan capital without adding one whit to the productive capability of this country. This record demand for credit for nonproductive corporate takeovers is directly limiting the availability of credit for other, productive uses and driving up interest rates for everyone. Second, our nation's economy is locked on track with a more or less fixed combination of fiscal and (unless changed) monetary policies which will keep interest rates destructively high and volatile for the next year at least -- unless relief is provided through the channel of credit controls.

On corporate mergers and their impact on the demand for credit, our coalition published just last month a study by Stephen Brobeck, executive director of the Consumer Federation of America and a member of the steering committee of the Low Interest Rate Council. Our report, "The Merger Boom and High Interest Rates," summarizes the impact on credit markets of the current wave of corporate takeovers and the massive use of loan capital and lines of credit to finance those mergers. By 1981 merger activity had reached an all time high, rising from $11.8 billion in 1975 to $44.3 billion in 1980 and finally to $82.6 billion in 1981. Lines of credit held open in our Nation's banks to finance planned mergers by these blue chip corporate borrowers tied up an estimated $70 billion. The estimated $34 billion in merger-related bank loans exceeded all new loans to farms and all new loans to state and local governments in that year.

These merger loans and lines of credit for these nonproductive investments squeeze out productive users of credit such as industry, housing, farmers, utilities, and state and local government. Why, we ask, should corporations like U.S. Steel, Dupont, Mobil and Fluor tie up money that could better have gone for industrial investment or home mortgage loans? "Tilting" available credit away from nonproductive uses and toward productive investments will have the effect of increasing the available supply of capital and lowering interest rates for productive uses of credit.

Basically there seems to be no viable alternative to selective credit regulation as a means of lowering and stabilizing interest rates in the existing environment of fiscal policy. The credit markets, according to many observers, seem to believe that tight controls on the growth of the money supply is necessary. If Wall Street perceives that the money supply is growing too rapidly, it is said, then interest rates will go up in the expectation of increased inflation in the future; conversely, if the Federal Reserve Board were to tighten down further on the growth rate of the money supply, interest rates would also be driven up by limited supply. Moreover, the framework of fiscal policy is more or less fixed for the next year through the Congressional budget process. Present estimates show the Treasury issuing between $85 billion and $120 billion of new debt during the second half of this year --a demand for credit incompatible with economic recovery and with unlimited credit demands for unproductive corporate mergers. While the projected federal deficit of $100 billion or more is considered by many to be irresponsibly expansionary, we note that each one percent of unemployment adds some $27 billion to that federal deficit, and that a four perent reduction of unemployment -- from 9.5 percent of the workforce to 5.5 percent --would produce a federal budget surplus of several billion dollars. At 4.5 percent unemployment the present budget would be producing a surplus of more than $30 billion.

Whether one "likes" them or not, the macroeconomic parameters are basically fixed. Yet we find continuation of this punishing, irrational recession intolerable. The one alternative we see -- and the one support -- is the tilting of available credit toward needed productive uses, as provided in H.R.6124.

For those who would decry any loss of independence of the Federal Reserve Board through such an invocation of credit controls, I would like to point out that ours is the only major industrial nation which allows such total and extreme independence to its monetary authorities. According to a recent survey prepared by the British-North American Committee, on which I serve, only Germany among the major industrial countries has a central bank which is "largely independent" of the national government in pursuing its duties, and even there the Bundesbank is obligated to support the national government's general economic policies. In countries such as Austria, France, Italy, New Zealand, Spain, Sweden and the United Kingdom the central bank is subject to the general direction of the government. And in Belgium, Finland, Japan, the Netherlands and Norway the central bank "must obtain specific government approval" for important policies. Do we want to maintain that the United States really has benefited from the extreme independence of the Federal Reserve Board?

Mr. Chairman, the call for lowering interest rates is a nearly universal one. Much of the business community, all of organized labor, farmers, the savings and loan industry, representatives of minorities and the poor -- all are beseeching the government to bring interest rates down and place them under control.

Even our friends abroad are looking to us to stabilize our own economy by reigning in interest rates, an action that in turn will help them to settle their economic turmoil.

President Reagan himself has said that once the Republican budget was adopted, interest rates should decline to ten percent. We agree.

What could do more to restore the credibility of our Federal government than taking the bold action necessary to show it has the ability to restore the health of our economy?

The necessary action can begin with the adoption of the Low Interest Rate Act of 1982.

Chairman **Annunzio**. Thank you, Mr. Turner, for a very excellent, practical, and informative statement. We have a vote on the floor of the House.

I am going to ask the panel to remain.

The members will be back, and we have some questions that we would like to ask.

We will be back immediately after the vote.

[Brief recess.]

Chairman **Annunzio**. The meeting of the subcommittee will come to order.

Mr. Sheehan, could credit controls be used to bring down interest rates sufficiently to reverse the type of lending that has swept over the savings and loan associations?

Mr. **Sheehan**. Mr. Chairman, our experience in 1980, when the credit controls were put into effect for 3 or 4 months, was that interest rates did come down. It helped the savings business considerably, because our cost of money went down and naturally it helped the homebuilder and the labor people, because things came up for 3 or 4 months, for that small period of time.

Chairman **Annunzio**. I know you have expressed yourself on this before, but in the recession under Carter, when he did use credit controls, as you mentioned, interest rates did come down, and this is exactly what all of us are striving to do; so, in your opinion, if you were advising the President of the United States, because there is nothing mandatory about this policy—you don't look a gifthorse in the mouth—how would you advise the President, as far as this legislation?

Let us be practical here this afternoon. The administration is against it. This bill will pass this subcommittee. We have enough votes on our side, and I think the chairman would agree with that statement I think on our side, to pass it in subcommittee, but we are going to have a big job in the full committee.

We are all going to work hard for it. How would you advise the President?

Mr. **Sheehan**. Well, Mr. Chairman, I certainly would advise him at the appropriate time to enforce or to put into effect his powers in order to, as Mr. St Germain's original bill states, to prevent recession, to help employment, and to control interest rates, three different things you are trying to do in your bill.

The only criticism that I was conscious of with the 1980 Credit Control Act, was that there was apparently a congressional study made, saying that it was not effective. But they did say in this particular study and I am quoting from it:

> A retracing of the events leading to the imposition of the Credit Control Act 2 years ago strongly suggests that the Presidential powers delegated to the Federal Reserve were conferred in haste and without appropriate congressional hearings as to the potential impact on the economy.

So it would seem to me, if I were the President, I would want to invoke them, but then I would have the Federal Reserve or whomever has the power, to come back to Congress and say, hey, this is what we are going to do that would give the Congress a chance to see what the regulators are going to do. This would give the President sufficient protection and give you Congressmen a hand in it and save all the problems that Mr. Carter had.

Chairman **ANNUNZIO**. Thank you.

I note that two more subcommittee members are here. I would like a member of my staff to keep time. I don't want any more than 5 minutes to ask questions, and I want each member to have 5 minutes to ask questions, and then if they have additional questions, we will go back. Whenever my 5 minutes are up, let me know.

Mr. Sheehan, the Fed has put much emphasis on monetary policy. Do you believe that this single minded emphasis has succeeded in keeping the recession from becoming worse, or is it part of the problem?

Mr. **SHEEHAN**. Well, I would say, in my opinion, Chairman Annunzio, it is part of the problem.

I feel personally that there is no good reason for these high interest rates to be existing today.

I am inclined to blame this on the big bankers. I see no reason when they have about a 5 or 6 percent spread of the cost of their money and the cost of the prime, that they have to keep these high interest rates on, and it is the consumer who is paying the burden: the labor man, the homeowner, and the farmer here.

They are going to their local banks and trying to get money, and the banks are demanding 16 to 21 percent.

Part of it is the big banks, and part of it is the money market funds. Why?

The guy in Podunk, Iowa, and the guy in a small city in Illinois, he wants to put his money into the money market funds, because he is getting 13 or 14 percent.

The greatest part of the money market funds goes to the big banks. The big banks are giving it to the people who can afford to pay 20 or 21 percent.

We can't afford it in the savings and loan business. We traditionally work on a spread of 1¼ to 1½ percent. I see no reason why the big banks need a 5- to 6-percent spread.

Continental Illinois Bank loses $100 million. With the Drysdale, securities scandal the big banks lose $1 billion. Who is paying for that but the smaller people who are getting high interest rates, because it goes to the big guys? This is an opinion I particularly have.

Chairman **ANNUNZIO**. I hope you are happy in the savings and loan business, because you are thinking just like I do; you would make one hell of an opponent in the 11th District.

Mr. **SHEEHAN**. Frank, you know my high regard for you for many, many years, as a Republican and as the guy who was the leader of the Reagan political campaign in Illinois, and we came up with 400,000 majority for them when nobody else thought—I still feel that you do a great job in our district.

Chairman **ANNUNZIO**. I am sure happy to hear that.

Mr. Paul?

Mr. **PAUL**. Thank you, Mr. Chairman.

I first would like to ask unanimous consent to submit a letter from Mr. Richard Pratt of the Federal Home Loan Bank Board for the record.

Chairman **ANNUNZIO**. Without objection.

[The letter follows:]

Federal Home Loan Bank Board

RICHARD T. PRATT
CHAIRMAN

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

JUL 1 4 1982

Honorable William J. Stanton
Committee on Banking, Finance
  and Urban Affairs
House of Representatives
Washington, D. C. 20515

JUL 14 1982

Dear Mr. Stanton:

This is in response to your request for our comments on H.R. 6124, a bill that would provide authority under the Credit Control Act of 1969 (the "Act") on a permanent basis. The authority for the Act expired June 30, 1982. H.R. 6124 would also broaden the "triggering" mechanism in the current law to authorize the Federal Reserve Board to regulate and control any or all extensions of credit whenever the President determined it was necessary to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession. The Act now refers to use of its special powers in controlling inflationary uses of credit.

The specific measures that the Federal Reserve might take under the Act are virtually all-inclusive. For instance, it could require licensing or registration of transactions and provide for limitations on such licenses; prescribe record-keeping requirements; specify or limit the terms and conditions for extensions of credit, including interest rates, amount of credit extended, and maturity; specify limits on ratios of loans to deposits or assets; or even prohibit any extension of credit. Finally, H.R. 6124 would add a new power to those previously exercised by the Federal Reserve Board under the Credit Control Act, in that it would permit the FRB to prescribe limitations "with respect to credit for non-productive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes."

As a general matter, I believe that free markets are the most efficient allocators of economic resources. Experience, other than in wartime, with economic controls such as those envisioned under the Credit Control Act has been highly problematical. Additionally, while having such stringent controls available on a stand-by basis for use in times of economic emergency might be helpful, I am confident that Congress would respond rapidly to address evolving circumstances should it appear that mandatory controls were in the public interest. The House of Representatives has demonstrated such responsiveness several times over the last year in responding to the very volatile conditions in the financial community by acting very quickly to pass a resolution affirming that the full faith and credit of the United States stands behind the federal deposit insurance agencies, to pass legislation which would provide temporary net worth support for the savings and loan industry, and to pass certain extraordinary powers for the regulators under the so-called "Regulators' Bill."

I hope this response has adequately addressed your concerns. Please note that in accordance with 12 U.S.C. § 250, this letter has not been reviewed outside the Federal Home Loan Bank Board and does not necessarily represent the views of the President.

Sincerely,

Richard T. Pratt

Richard T. Pratt
Chairman

Mr. Paul. I would like to make a general statement and apologize to the chairman, because I need to leave shortly to go to the House floor, but, I, too, like everybody else, am concerned about high interest rates. I have not met anybody in the Fed or in the administration, or on the House floor that is for high interest rates.

I think there is a bit of confusion, though, when you see an economist, one that I highly respect, come up with a statement like Milton Friedman did, saying that he really does not quite understand why interest rates are high. Because I disagree with him on monetary policy, I can see why he makes a statement like that.

But I think the most important point that I would like to make, the one point everybody fails to see—and I happen to believe very firmly until we address this subject, interest rates are going to go higher and get worse—whether you have credit controls or not, we will see interest rates of 30, 40, and 50 percent, as we have seen in many other nations of the world.

Even though we have spent many decades with discretionary monetary policy, we have moved into an age in the last couple of years in which we have adopted a policy of monetarism, where the Fed have concentrated on the supply of money and not interest rates, and yet we have not seen any good results.

The main thing the Fed has failed to address is the subject of quality of money. You can control the quantity of money, and that is important, but the quality and integrity of the money are important, too.

For this reason, until we have a money that we can trust, until we deal with the trust factor and the risk factor, you will never get anywhere in trying to understand interest rates by saying real interest rates ought to be 3 or 4 percent, and the inflation any premium ought to be 3 or 5 percent, and, therefore, you should have interest rates no higher than 10 percent.

When you deal with interest rates, you totally understand why interest rates could be 16, 18 or 25 percent. Regardless of how fast prices go up, and until we have a real currency, I think we will be in this dilemma, and things will get much worse. The specific question I have for the panel, and, in particular, Mr. Sheehan, is: How can you accept the idea of giving additional power to the Fed?

The Fed is going to operate these controls. The chairman isn't going to do it; the Congress isn't going to do it. We abdicated our responsibilities by giving this to the Fed, even though we have the responsibility to do something about the money and interest rates.

We have a strong coalition in the Congress right now, demanding and insisting, for once, that we open up the books of the Fed and see how it operates.

Instead of not opening up the books of the Fed and finding out what is happening, we give them more power. They might allocate credit exactly the opposite of what you want. They might decide to give more credit to the larger corporations than they are getting now, and make the situation much worse.

I wish we could amend this instead of saying give more power to the Fed and allowing them to do more to us; we ought to consider auditing the Fed and know exactly how the system operates. How, under these circumstances, can we stand the idea of giving the Fed more power instead of thinking about giving them less, since you are not pleased with the Fed?

Mr. **Sheehan**. I did state before that a study was made, and I don't know who made it. I have the study here, but it did say in order to put this thing in the record, contact Godfrey Briefs or Gregg Wilson for more information.

They apparently wrote a report on the effect of the 1980, under the Carter administration, putting the credit controls on. In their statement they said, and I firmly believe in this, because in my years of Congress here, I know we were always griping and hollering about the regulators.

Chairman **Annunzio**. For the benefit of Mr. Sheehan, Godfrey and the others were three minority staff members, members of the Republican Party, who wrote that.

Mr. **Sheehan**. Then I would say this, Mr. Congressman, it is more appropriate, because they pointed out that if the Fed, before putting this thing on and making a decision, were to come back to Congress, and tell you what they were going to do, this would give the President protection.

Chairman **Annunzio**. That is absolutely correct.

Mr. **Paul**. Are they going to be obligated to do that?

Mr. **Sheehan**. I would like to see them obligated. Before they obligate, the Congressmen would have a chance to see it and look at it. They write a law, and it goes to the regulators, and they interpret it differently.

Mr. **Paul**. I can't understand your unfailing trust in the system. You are trusting the Fed to do what you are asking them to do.

Mr. **Sheehan**. I am trying to say they ought to come back and report to you fellows and get the congressional OK without doing it blindly.

Mr. **Paul**. You have admitted that does not happen. We turn it over to the regulators. We have not touched the money system since 1913, and look at what we have had, total chaos, and now virtually the destruction of the dollar. Now, we want to give more power to the Fed? It seems inconsistent.

Mr. SHEEHAN. I think offhand the Congress ought to maintain or keep some of the power so the regulators come back and don't interpret what they want to interpret into the law. Too frequently the regulators are supposed to go through the hearings and pick up what Congress meant. They just interpret it the way they want.

Mr. PAUL. I can support that improvement.

Thank you.

Chairman ANNUNZIO. Your 5 minutes are up.

Mr. St Germain?

Mr. ST GERMAIN. You say you would support that improvement, but that would not lead you to support the legislation?

Mr. PAUL. Not the legislation, but I would certainly support seeing that Congress takes more responsibility over the Fed and not, you know, give more power to the Fed.

Mr. ST GERMAIN. I just want to express my appreciation to the panel. You have made your points, and your written submissions are excellent, and there is no way that I can embellish upon it. I am most appreciative of your collective support. That is what we are looking for, is support, but we are also looking for that which you provide, Senator Miner, the grassroots testimony of what is actually happening out there around the country.

I think we have to be responsive to that. When you look at the numbers that you cited to us, how in God's name can those people survive? They can't. They can't.

Mr. Turner represents labor; we have had many hours together, discussing this legislation. We discussed its importance not only to the members of the labor movement that you represent, but to the many people out there who are the small business people and the consumers, the potential homeowners.

Mr. Davis, it is a pleasure to have you testify. There is no doubt of the fact that, believe it or not, Wall Street is affected here, and very, very adversely, because of the unrealistic interest rates that prevail.

Why would a businessman want to risk capital in expanding his business when he can put the money into a jumbo CD or high-paying money market funds and with no risk, get a guaranteed return on his money? So we are stifling the American enterprises, very definitely.

Mr. Sheehan, I want to compliment the United States League on bringing us a very excellent witness, and we appreciate your assistance, your testimony, and your support.

Thank you, Mr. Chairman.

Chairman ANNUNZIO. Thank you, Mr. Chairman.

I have two more questions, really three, so that I can get your responses on the record.

Senator Miner, can today's farmers successfully compete with Mobil and Texaco for credit in a free market?

Mrs. MINER. It doesn't look like it, does it?

Chairman ANNUNZIO. Mr. Turner, you cited in your testimony the devastating effect that high interest rates have had among farmers, construction workers, auto workers. Is there any industry that has not been affected by high interest rates?

Mr. TURNER. I do not know of any which have not been adversely affected by high interest rates.

Chairman ANNUNZIO. High interest rates—do you agree with this statement—have permeated every facet of life of every human being in this country? Would you agree with that?

Mr. TURNER. I certainly would. It has completely crippled our society.

Chairman ANNUNZIO. Mr. Davis, you point out in your testimony that we are at a time of paradox—expensive, easy money, and you put part of the blame on banking deregulation, which is up my alley. I did not sign that deregulation conference report. I was the only member. Is the phasing-out of regulation Q providing the deposit interest ceilings partly to blame for this phenomenon?

Mr. DAVIS. Absolutely. Historically, banks were limited by regulation Q on what they could pay, and if prices rose, if you had a boom in business, inflation, the interest rates would go up to that rate, and then the banks could not attract money at that rate, and people would say, well, the banks won't pay me more than 5 percent; I will go out and put my money into government, equities, corporate bonds, long-term, and that made long-term credit unavailable.

Now, we have the reverse of that. We have reversed the competition from the banks' desire to make loans competitively to the banks' desire to pay the most so they can attract the funds, because they know they can pass on that higher cost to the borrower, and so it has become a destructive upward cycle and the benefit of disintermediation has disappeared completely.

You have no access to money by even the best corporations—no access to long-term equity by any corporations. It pushes everybody back into the need, the desperate need, for short-term funds at these high rates.

That is the only market available to them, and so if you wanted a design, Mr. Chairman, a system, an approach to destroy the capitalistic system, you could not design one better than we put together here in our economy today; and to say that the Fed has been ineffective is absolutely true, but this administration and the people elected here have a responsibility to make things happen, not to do surveys or to question Treasury Secretary Regan or President Reagan. Theirs is not to predict; they are to make things happen. They have to take actions, for better or worse—better anything than what we have now—so I urge that this subcommittee move aggressively ahead, and I pray that they are successful.

Chairman ANNUNZIO. Thank you, Mr. Davis. Your answer has heartened me, having been the only member of the committee that did not sign that conference report. You have convinced me now that I was right. That is the way I feel.

I want to thank each and every one of you for your constructive contribution to the legislation. I am sure that, as the subcommittee reads the record and we further deliberate this legislation, that your statements and your answers to questions will help us reach a final determination.

I am very seldom wrong on my subcommittee, but I want to say to you that as far as this subcommittee is concerned, I feel we are going to pass the Credit Control Act. I am not responsible, but I will work like hell on the full committee, so I state my position in advance to those who will appear tomorrow and the next day against this legislation.

I want my position clearly understood. I favored credit controls back in 1980, and I favored the standby authority that we gave President Nixon. I made that a major campaign issue in 1972, the rollback, wages and prices, and some of my good pals in the labor movement were not always for the program, but are for the program provided it is an all-inclusive program. They want it across-the-board. That is a very difficult program to sell, but it did save.

Standby controls saved what was left of the Nixon administration at that time. Standby controls saved the Carter administration, and I want to tell you this administration needs something if it is going to live, and I think this is a vehicle that they need. I know the American people need it, but they need it for their administration, because, when we talk about 9.1 million out of work, we are not talking about those that are indirectly affected.

You come to my city of Chicago, and we have pockets of unemployment where 25 percent of the population is unemployed.

This thing cannot exist. This situation cannot exist in a free society if that society is to remain free; so I thank each and every one of you for your appearance here this morning.

The next panel is Ruth Kobell, legislative assistant of the National Farmers Union; Mr. Henry Schechter, director, Office of Housing and Monetary Policy of the AFL-CIO; Mr. Sheldon Friedman, research director of the United Auto Workers; and Mr. David Stahl, executive vice president of the National Association of Home Builders.

You all have prepared statements, which I have before me; so I will ask unanimous consent that your entire statements be made part of the record, and, without objection, they will be made part of the record.

I ask that you proceed in your own manner for 5 minutes or so, and then if there are any other members of the panel present, we will have questions. I have talked with the subcommittee members, and some of you will be getting questions from them, and I am keeping the record open for some reasonable time. The time is limited. I don't want to announce a couple of weeks and then we will close it, because I wish to get to markup of this legislation.

Our first witness today is Ruth Kobell, legislative assistant of the National Farmers Union.

STATEMENT OF RUTH E. KOBELL, LEGISLATIVE ASSISTANT, NATIONAL FARMERS UNION

Ms. Kobell. We appreciate the opportunity to be here. I have with me today Mr. Hal Long from Garber, Okla., who is a John Deere implement dealer along with his father, brother, and his son, and I have felt it would be much more appropriate for him to talk to us about what interest rates have meant to the small businessman in rural America, and I would ask that my time be used by Mr. Long in his presentation.

[Ms. Kobell's prepared statement on behalf of the National Farmers Union follows. Also submitted was a publication of the

National Farmers Union "Depression in Rural America," available from the Department of Field Services, National Farmers Union, Denver Colo. 80251.]

National
Farmers Union

STATEMENT OF

RUTH E. KOBELL
LEGISLATIVE ASSISTANT
NATIONAL FARMERS UNION

PRESENTED TO

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE
OF THE U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

WASHINGTON, D.C.
JULY 14, 1982

The Wall Street Journal recently quoted a Republican member of the U.S. House of Representatives as believing that "practically speaking there isn't much that can be done" to bring interest rates down.

Almost everyone in the nation agrees that lower interest rates are the key to economic recovery, to new life in the housing and auto industries, to improved net income on the farm and to increased consumer purchasing power.

It does not matter much whether such defeatism about reducing interest rate levels is a sincerely held belief, a pretense or a cop-out. The net effect is dangerous and damaging because it tends to ignore or obscure the most direct route to lower interest rates.

There is, after all, nothing impossible about bringing interest rates down, if there is any will to do so.

Interest rates are high, not because of market factors, or divine ordinance, but because the White House and the Federal Reserve Board of Governors want them high.

Interest rates will stay at devastatingly high levels as long as Administration policy-makers and the "FED" want them there.

In the Farmers Union, we are not much impressed with the rhetoric which suggests that interest rates are high because the federal budget is "out of control."

There is no demonstrable evidence of a connection between federal deficits and interest rates, or for that matter between federal deficits and inflation.

Since 1929, there have been 47 years in which the federal budget was "in the red" but in only 16 of those years has the inflation rate exceeded 5% and in only ten of those years has the prime rate of interest exceeded 6%.

The claimed relationship between federal deficits and high interest rates is suspect, in our opinion, because federal debt is only about 14% of the total public and private debt load of more than $7 trillion.

The federal debt is dwarfed by the private borrowings of $5.7 trillion.

True, federal debt has more than doubled since 1975 (and since last October 23, has exceeded a trillion dollars), but private debt has roughly tripled in the same period.

All of the attention now seems to be fixed upon the volume of borrowing which the U.S. Treasury Department will be doing in coming weeks and months, while little is said of the massive corporate refinancing which will be taking place.

Certainly, not enough is said of the wasteful diversion of $60 to $70 billion a year in the financing of corporate takeovers, which serve no apparent useful purpose for society.

Earlier, we stated that interest rates can be held at reasonable levels if there is a will to do so. It is useful to remember that while the current policy-makers cannot seem to find the key to lowering the present 16½% prime rate, it was both possible and feasible for the Franklin D. Roosevelt and Harry Truman Administrations to hold the prime rate continuously at or below 3% for more than twenty years, a time span which included war, depression and other difficulties.

As a matter of fact, for 13 years from April 1934 to September 1947, the prime rate was continuously held to 1% or less. (See ATTACHMENT "A".)

We indicated at the opening that the most direct route to lower interest rates was being ignored.

That is to direct the Federal Reserve Board either by legislative or executive order to lower interest rates or otherwise control the extension and terms of credit.

Authority exists in broad and general terms under Public Law 95-523, the "Full Employment and Balanced Growth Act of 1978."

Through June 30, 1982, more specific authority existed under Public Law 91-151, the Emergency Credit Control Act of 1969, under which the President could direct the Federal Reserve Banking system to take certain actions to limit and regulate the extension of credit, set interest rates and repayment terms, and to allocate credit to productive uses.

The Emergency Credit Control Act of 1969 was only implemented once, by President Carter in 1980, and then abandoned within about two months, without having utilized the credit allocation authority.

In several instances, in presenting testimony to the committees of Congress on the credit situation and high interest rates, National Farmers Union recommended the extension and use of the powers under the 1969 Act. (See ATTACHMENT "B".)

We regard the House bill, H.R. 6214, as very desirable since it not only extends the life of the 1969 Act, but also provides authority for the limitation of the use of credit for nonproductive purposes such as corporate take-overs. Similarly, the Senate bill, S. 2526, deserves early consideration.

We are aware that the White House does not want this legislation and may not use the authority if the bills become law.

One other alternative is still available, in that the Congress could by direct legislation order a specified roll-back of interest rates.

The board of directors of the National Farmers Union, meeting in May of this year, in Washington, D.C., recommended legislation which would mandate a roll-back of interest rates by at least 2% each calendar quarter for the next year. The practical effect would be to reduce the prime rate from the current 16½% rate to about 8% in a year's time.

Our Board made this recommendation, recognizing that reducing the federal budget deficit to the neighborhood of $100 billion or of making verbal suggestions to the Federal Reserve to reconsider its money supply targets, are largely cosmetic approaches unlikely to have any desired immediate effect.

On the other hand, believing that the reduction in interest rates is imperative and must be the initial and primary objective, our Board proposed the "rachetting down" of interest rates by at least 2% each calendar quarter beginning October 1, 1982.

Such a roll-back of interest rates by at least 8 points in fiscal 1983, would not only be a god-send to consumers and to the basic industries such as agriculture, housing and automobiles, but also would assure major savings in the federal budget itself.

Gross interest outlays on the federal debt are now likely to be $133 billion in fiscal 1983, rising to more than $200 billion by 1987. Over the five-year period, failure to reduce interest rates to tolerable levels will add more than $600 billion to the federal deficits.

One may not prefer the stern medicine of credit controls and credit allocation, but they are clearly more acceptable than the intolerable alternatives of harsh inflation, recession, high unemployment and hardship.

We believe that the time is here for a direct attack upon the interest rate problem. The interest rate reduction will have to come first if there is to be a sustainable economic recovery.

ATTACHMENT "A"

PRIME INTEREST RATE, SELECTED YEARS 1933 - 1953

1933	1.73
1934	1.02
1935	.75
1936	.75
1937	.94
1938	.81
1939	.59
1940	.56
1941	.53
1942	.66
1943	.69
1944	.73
1945	.75
1946	.81
1947	1.03
1948	1.44
1949	1.49
1950	1.45
1951	2.16
1952	2.33
1953	2.52

ATTACHMENT "B"

1982
Policy
of
National Farmers Union

Adopted by Delegates to
the 80th Annual Convention

Washington, D. C.
February 26-March 2, 1982

ARTICLE II
CREDIT PROGRAMS
FOR THE FAMILY FARM

As of January 1, 1982, United States farmers had outstanding debts of about $200 billion. Interest outlays in 1981 were about $20 billion, which means that farmers had $10 of debt outstanding for each dollar of net income. By comparison, in 1975 farmers had $3.33 of debt for each dollar of net income.

By other measurements, such as the debt to asset ratio and the debt to equity ratio, the present situation is the most unfavorable in 40 years.

If farmers are to sustain needed production, borrowing is not a discretionary thing. Farmers have had to substitute credit for income to an alarming degree. In 1970, American farmers depended upon borrowing for only 5.2 percent of their cash sources of funds. By 1980, the dependence on borrowing had risen to 20 percent and, in 1981, to 23 percent.

The situation in 1981 was one in which farmers had to borrow more and pay higher interest rates, while sagging income sharply reduced their ability to repay the loans.

This has put many farmers in a precarious position, facing liquidation or foreclosure. To enable them to continue in production in 1982, we propose additional emergency lending as needed, together with a one-year moratorium on principal and interest payments due to the Farmers Home Administration (FmHA).

Farm credit is not a substitute for parity farm prices and income.

Access to adequate credit at reasonable cost is essential if family farmers are to operate effectively and competitively. Government policies and programs should be designed to assure an adequate flow of credit to independent farmers.

We deplore the constant escalation of interest rates which imposes an intolerable burden, especially upon beginning farmers. It is absolutely necessary for the survival of family farm agriculture that we return to long term fixed interest rates not to exceed 8 percent.

D. Money and Credit Policy

Farmers are drastically injured by the current high interest rates being employed, without success, to dampen inflation.

A better remedy is available in the form of the emergency powers conferred on the President by the Emergency Credit Control Act of 1969, under which the President may limit credit use, may prescribe interest rates and credit terms and, if needed, may allocate credit to productive uses. Severe as such actions would be, they are preferable to continuing the present totally ineffective policies.

The Federal Reserve Banking Board should be compelled to conform its policies to the goals of the "Full Employment and Balanced Growth Act of 1978", and it should be made accountable to the U. S. Congress for policy-making activities. Federal Reserve statutes should be amended to require representation of agriculture, small business, and labor on the Federal Reserve Board. To insure a unified national economic policy, the Federal Reserve System should be a part of the executive branch of government and made responsible directly to the President.

Chairman **Annunzio**. Mr. Long, I have a statement from you. Your entire statement that I have before me will be made part of the record, without objection.

Will you proceed in your own manner? Ms. Kobell, if you want a minute or two, I know the other panel members will not object. As far as this subcommittee chairman is concerned, I am ready to sit here to listen to all of you.

Ms. **Kobell**. Thank you. Earlier this year our national president, George Stone, had a series of nine field hearings to document not only what the conditions of rural America were in relation to farmers, but to small businessmen. We circulated that report entitled, "Depression in Rural America" to all Members of Congress.

Mr. Long is here, and I am delighted he can bring that message from rural America to you today.

STATEMENT OF R. HAL LONG, JOHN DEERE IMPLEMENT DEALER, GARBER, OKLA.

Mr. **Long**. Mr. Chairman and members of the subcommittee: I am R. Hal Long from Garber, Okla. My father became a John Deere farm implement dealer in 1934 at Garber, a wheat and cattle community in North Central Oklahoma, near Enid. My brother and I joined this business after military service and college and expanded into three other dealerships, with my son operating one at this time. High interest rates have become of great concern to us. Most implement dealers in our part of the country are not in a recession—they are in a depression.

I will give you two examples of what the high interest rates are doing to implement businesses. Our store with the biggest loss and most interest expense is not included, only the two which are the best capitalized and have consistently had the best profitability.

The Garber store's 7 month, year-to-date sales have dropped 56 percent as compared to the same period last year—from $2,317,000 to $1,034,000. Interest cost has risen by 81 percent—from $19,370 to $35,098. Profit has dropped by $147,000—from $48,000 profit to a $99,000 loss. Interest cost to sales has increased 4.25 times—from 0.8 percent to 3.4 percent. The 1971 interest cost to sales was only 0.8 percent—the same as last year.

The Blackwell store, which is located in Kay County, one of the outstanding agriculture counties in Oklahoma, has had much the same results with sales dropping 52 percent, interest expense rising by 100 percent, and profit dropping by $177,000 to a loss of $131,000 for the same 7 months.

Other than the obvious direct cost of interest to us, there are larger negatives with which to contend. It wasn't long ago that interest was 8 percent and inflation about 10 percent. Our static inventories, such as repair parts, a decent stock of new implements and a reasonable stock of used implements, would appreciate at about the same rate as the interest cost. At this time interest is 10 percent higher and inflation 5 percent lower—making a 15 percent swing in the cost versus appreciation on these inventories. We like the low inflation, but we can't handle the high interest.

Used implement inventories are not holding their own by several percentage points because the farmers are not able or willing to buy with interest rates as they are.

Implement manufacturers have been discounting new machinery to offset the high interest rates, and in many cases to generate cash flow so that they may survive, at least temporarily. This has had a negative effect on the implement dealer also by causing his high quality—high dollar used tractors in inventory to drop in price. Also some new sales have been made in lieu of what would probably have been a used sale. The profitability of the new sale involving a trade is very questionable and the used inventory has been increased rather than decreased. Hundreds of excellent used tractors are sitting on dealers lots which normally would have been sold at this time with the good prospects and crop which we have had. When a dealer cannot merchandise used equipment for whatever reason, he really can't sell new and stay in business.

It is estimated that 20 percent less implement dealers will be in business when times get back to normal. Towns like Garber cannot afford to lose its dealer. Like many other rural towns, the implement dealer and the farmers co-op are about all of the businesses left that hire many employees. Small town America is gasping for life.

Farmers tell us that they are not even buying repair parts until they have a costly breakdown because of the high interest rates—this is poor economics but our books show it is a fact. Futhermore, their tractors and implements are deteriorating excessively because preventive repairs are not made.

The hestitation to trade up is going to cause many small- and medium-sized farmers to be unable to compete when the farm economy is again normal. Each year that the farmer has to put off buying, it will make it harder for him to expand when the time comes that he will need to expand to survive. The effect of high interest rates it not only evident now but will be very damaging to the farmer's future.

Short of going out of business, most implement dealers cannot cut their costs appreciably and maintain any kind of service to their farmer customers who need service now more than ever. Of course inventories are being reduced when possible—sometimes at the customer's disadvantage—especially when repair parts are not put back in the bin and the customer has to lose precious hours or days waiting for his repair parts to arrive.

High interest rates have a very detrimental effect on the price of the farmers product which in turn makes it tough on the implement dealer. With the cost of interest at about 60 cents per year on a bushel of wheat and storage at 30 cents, the farmer has little choice about selling his wheat. Interest rates not only affect the overseas price and sale of wheat, but have a very definite affect on the local price.

For farmers, implement dealers, and our proud rural American heritage to survive, we must have lower interest rates immediately. To do this, we must expedite most, if not all of the following:

First, pass a balanced budget amendment with some flexibility; second, cut down on entitlements; and third, forgo the upcoming tax cut.

Thank you for your time and concern on such an important issue.

Chairman ANNUNZIO. Thank you for your excellent remarks, they are fitting. Sometimes people in the United States get a feeling that, and I understand it, no one is listening or no one cares, you see, and that is what the Government is about.

I don't want to get involved in supply side, no supply side.

This thing that bothers me today, people say, well, we don't need the Credit Control Act. We are not at war. Well, hell, this is war.

That is what you have all got to start selling. We are at war. We have got to bring this house in order.

The next witness is an old friend who has appeared before this committee many times, Mr. Schechter. I also enjoy your contributions. Mr. Schechter is director of the Office of Housing and Monetary Policy of the AFL-CIO.

STATEMENT OF HENRY B. SCHECHTER, DIRECTOR, OFFICE OF HOUSING AND MONETARY POLICY, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. SCHECHTER. I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Chairman ANNUNZIO. We have already reached 50 cosponsors. The list is growing every day.

Mr. SCHECHTER. I hope we can get more. We will keep trying.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. The AFL-CIO position was validated in 1980. Credit controls, introduced for about a 3-month period in 1980 under authority of the Credit Control Act of 1969, were helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started 2 months before the March 14, 1980, date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. After credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,555,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up. The modest use of credit control authority led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

However, with periodic public guidance from the Reagan administration, the Fed has steadfastly pursued a restrictive monetary policy in the past 18 months. In 16 of those months, the prime rate was in the 16 to 20 percent range and 2 months at 15¾ percent. Mortgage interest rates are at about 17 percent, and U.S. Treasury notes of 2 to 7 years carry 14 to 15 percent rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. There is a growing consensus that a meaningful recovery from this depressed economic condition is not possible without a significant reduction of interest rates.

There has also been a basic change in the economy that maintains economic demand for types of expenditures that can support high interest rates. There was a doubling of media family real income—measured in dollars adjusted for price changes—between 1947 and 1979; but also between 1967 and 1979-80, the share of total family money income going to the top 20 percent of the income distribution has climbed from 40.4 to 41.6 percent in 1979-80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A casual factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income consisting of interest income. Higher income families have more savings and investments and gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2 percent. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982 of all personal income was interest income.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent. There were stories about it in Business Week and U.S. News & World Report and other publications.

Historical data are shown in table 1 for five types of annual personal consumption expenditures that can be characterized as selected discretionary income expenditures for luxury goods and services. The five selected categories are for first, recreation including sports equipment, bikes, boats, and pleasure aircraft; second, other recreation including riding, skiing, and swimming places, and golf courses; third, foreign travel and expenditures overseas; fourth, airline travel; and fifth, jewelry and watch expenditures. The percentage of total personal consumption expenditures accounted for by the five categories in some benchmark years were: 2.5 percent in 1947; 2.9 percent in 1960; 3.7 percent in 1970; 4.1 percent in 1980, and 4 percent in 1981.

The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and service that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757's and 767's which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment.

Companies are actually saying they don't want to accept orders for the planes, as the economy goes through adjustment. These higher priced goods and services have a thin market, even though they cater to the higher income group, they are not essential, and part of the production capacity for such goods and services becomes idle.

As incomes rose to higher levels, there were upsurges in direct investments by households during high interest rate periods which had a depressing effect upon inflows into savings accounts in the fifties and sixties, before there were money market mutual funds of any significance. The amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some—such as commercial paper—which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, the trend has accelerated. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

The response of the political and financial policymakers has been to follow a policy of increasingly embracing monetarism, even though such a policy failed in England, which had a few years that proceeded our experiences.

Leading economists have concluded that major elements of inflation during the seventies, resulting from periodic worldwide oil and grain shortages, could not be controlled through the money supply. I would add that a domestic housing shortage is another major element of inflation that is caused by supply-demand imbalance which is aggravated by high interest rates. In fact, authorities such as Economics Nobel Laureate James Tobin, New York Federal Reserve Bank President Anthony Solomon, Harvard Prof. Benjamin Friedman, and Wall Street financial practitioners Henry Kaufman and Albert Wojnilower have questioned whether control over a given total of financial instruments that is defined as the money supply, including the volatile amounts in NOW accounts, can really bring about a return to stable economic growth.

The financial and credit market analysts and practitioners are searching, groping, and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics, including Fed authority to outlaw floating rate credit contracts and to establish punitive margin requirements on certain types of securities futures trading. On a broader scale, however, there are three specific sugestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. Albert Wojnilower notes that "Growth limits for certain types of credit (a la March 14, 1980) may also have some promise."

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments.

Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rate to combat inflation repeatedly has proven ineffective. The "window guidance" type of credit control that has been used in Japan and which we really used here in 1980, can rapidly bring down interest rates, as in 1980, as banks that are exceeding credit extension limits, but have funds to invest, buy securities, bidding up the prices and bidding down interest rates.

H.R. 6124 is needed to reestablish and strengthen authority that can bring down interest rates and restore noninflationary economic growth.

[Mr. Schechter's prepared statement, on behalf of the American Federation of Labor and Congress of Industrial Organizations, follows:]

Statement by Henry Schechter, Director
Office of Housing and Monetary Policy
American Federation of Labor and Congress of Industrial Organizations
on H.R. 6124, a Bill to Extend the Credit Control Act
Before the Subcommittee on Consumer Affairs and Coinage,
Committee on Banking, Finance and Urban Affairs,
U.S. House of Representatives

July 14, 1982

Summary

I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. The AFL-CIO position was validated in 1980. Credit controls, introduced for about a three-month period in 1980 under authority of the Credit Control Act of 1969, were helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started two months before the March 14, 1980 date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. After credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up. The modest use of credit control authority led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

However, with periodic public guidance from the Reagan Administration, the Fed has steadfastly pursued a restrictive monetary policy in the past 18 months. In 16 of those months, the prime rate was in the 16 to 20 percent range and two months at 15 3/4 percent. Mortgage interest rates are at about 17 percent, and U.S. Treasury notes of two to seven years carry 14 to 15 percent rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. There is a growing consensus that a meaningful recovery from this depressed economic condition is not possible without a significant reduction of interest rates.

There has also been a basic change in the economy that maintains economic demand for types of expenditures that can support high interest rates. There was a doubling of median family real income (measured in dollars adjusted for price changes) between 1947 and 1979; but also between 1967 and 1979-80, the share of total family money income going to the top 20 percent of the income distribution has climbed from 40.4 to 41.6 percent in 1979-80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A causal factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income consisting of interest income. As more of total income goes into interest payments, it is to be expected that the income share of total personal income going to higher-income families would increase. Higher income families have more savings and investments and gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures. Incidentally, the average family income in the top quintile is eight times that in the bottom quintile.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent, as reflected in the following excerpt from an article in Business Week of March 9, 1981.

> "Although high interst rates have increased the costs of consumer borrowing, they have also become an increasingly important source of income to growing numbers of consumers who put money in high-yielding money market funds or cash management accounts. Interest income as a percentage of total personal income increased by more than one-third from 1973 to 1980, going from 8.8% to 11.9%.
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> "The two-tier consumer market is 'almost the sole reason consumer spending has outpaced forecasters' estimates,' says Albert G. Matamoros, vice-president and chief economist of Armstrong World Industries Inc. The weight of the top tier of the market in determining the strength of overall consumer spending is staggering.

Historical data are shown in Table 1 for five types of annual personal consumption expenditures that can be characterized as selected "discretionary income" expenditures for luxury goods and services. The five selected categories are for (1) recreation including sports equipment, bikes, boats, and pleasure aircraft; (2) "other recreation" including riding, skiing, and swimming places; and golf courses; (3) foreign travel and expenditures overseas; (4) airline travel; and (5) jewelry and watch expenditures. The percentage of total personal consumption expenditures accounted for by the five categories in some benchmark years were:

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The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and services that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757s and 767s which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment.

As incomes rose to higher levels, there were upsurges in direct investments by households during high interest rate periods which had a depressing effect upon inflows into savings accounts in the fifties and sixties, before there were money market mutual funds of any significance. The amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some -- such as commercial paper -- which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, the trend has accelerated. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

Instead of addressing the changed economic conditions with a method of reestablishing some stability in financial markets and also reducing the economically injurious high level of interest rates, the response of the political and financial policy makers has been to follow a policy of increasingly embracing monetarism, even though such a policy had failed in England.

Leading economists have concluded that major elements of inflation during the seventies, resulting from periodic worldwide oil and grain shortages, could not be controlled through the money supply. I would add that a domestic housing shortage is another major element of inflation that is caused by supply-demand imbalance which is aggravated by high interest rates. In fact, authorities such as Economics Nobel Laureate James Tobin, New York Federal Reserve Bank President Anthony Solomon, Harvard Professor Benjamin Friedman, and Wall Street financial practitioners Henry Kaufman and Albert Wojnilower have questioned whether control over a given total of financial instruments that is defined as the money supply, including the volatile amounts in NOW accounts, can really bring about a return to stable economic growth.

The financial and credit market analysts and practitioners are searching, groping and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics, including "Fed" authority to outlaw floating rate credit contracts and to establish punitive margin requirements on certain types of securities futures trading. On a broader scale, however, there are three specific suggestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. Albert Wojnilower notes that "Growth limits for certain types of credit (a la March 14, 1980) may also have some promise."

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments.

Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rates to combat inflation repeatedly has proven ineffective. The "window guidance" type of credit control can rapidly bring down interest rates, as in 1980, as banks that are exceeding credit extension limits, but have funds to invest, buy securities, bidding up the prices and bidding down interest rates.

H.R. 6124 is needed to reestablish and strengthen authority that can bring down interest rates and restore noninflationary economic growth. In addition to extending the Credit Control Act of 1969 beyond its expiration date of June 30, 1982, amendments would clarify that the credit control authority could be used to bring down interest rates in order to fight high unemployment and recession, as well as to fight inflation, to preclude the use of credit for unproductive uses, such as corporate takeovers, and to assure greater credit availability for productive purposes.

* * * * *

I appreciate the opportunity to present before you the views of the AFL-CIO on H.R. 6124, to extend the Credit Control Act. Chairman Annunzio and Chairman St Germain and all the cosponsors of this bill deserve a strong vote of appreciation from the American people for moving to reestablish a proven helpful alternative to the proven harmful sole reliance upon restrictive monetary policy to fight inflation.

Over the past decade, the AFL-CIO has adopted a number of policy statements and convention resolutions calling for implementation of the credit control authority when singular pursuit of Federal Reserve tight money, high interest rate policies has brought economic adversity, without attacking the real causes of inflation. Experience over the past two years has validated the AFL-CIO position. A short, modest use of the credit control authority in 1980 led to a rapid reduction of interest rates and cut the life of a developing recession to the shortest on record.

Credit Control Experience

Credit controls were introduced for about a three-month period in 1980 under authority of the Credit Control Act of 1969. The brief implementation of credit controls in 1980 was helpful in bringing down interest rates and getting the economy out of a recession. Contrary to popular belief, the recession started two months before the March 14, 1980 date on which credit controls became effective. Even though the first quarter of 1980, as a whole, did not show a decline in real GNP, the National Bureau of Economic Research places the business cycle peak at January 1980. That was the same month in which the index of industrial production and retail sales had also peaked.

The downturn in aggregate economic activity had been preceded by a decline in the interest rate-sensitive housing sector, as interest rates kept rising. The seasonally adjusted annual rate of new housing starts declined from 1,844,000 in September 1979 to 1,040,000 in March 1980 and to a low point of 938,000 in May.

However, after credit controls were instituted, interest rates on new mortgages for which loan commitments were made rose one more month to a peak of over 16 percent in April and then declined to about 12½ percent in July. The annual housing starts rate rose from the May low of 938,000 to about 1,550,000 toward the end of 1980. The prime rate charged by banks declined from 19½ percent in April to 11 percent in July when the decline in industrial production was reversed and the economy began to pick up.

As a supplement to traditional monetary policy, at various times during the past two decades, Japan has used credit controls to keep interest rates, inflation, and unemployment at low levels, and to help guide capital flows into productive, cost-reducing investments. In a recent study of the Japanese Financial System prepared for the Joint Economic Committee by a staff member of the Japanese Ministry of Finance, the author (Eisuke Sakakibara) speaking of monetary policy in Japan, states: "In addition to credit policy, the authorities often used window guidance to attempt to curtail bank loans directly. Although window guidance was sometimes heralded as a major policy instrument, it was actually only a supplementary tool. The Bank of Japan itself has said:

> 'Window guidance is a supplemental tool to general monetary policy tools such as discount rate changes, rather than an independent weapon of monetary control. In other words, while these tools exert pressure on the market, window guidance is a tool that reinforces them from the side. Since window guidance functions only as a supplemental tool of monetary policy, it would not be sufficiently effective unless it is used hand in hand with powerful enforcement of more orthodox tools of monetary policy."

Part of the credit controls implemented in the U.S. in 1980 were a fairly close copy of "window guidance" which has been used from time to time in Japan. Some of the more selective credit control measures used in Japan, when appropriate to promote stability, could also be used here under authority of the Credit Control

Act. Recently, for example, the authorities in Japan have forbidden the sale of zero coupon bonds in Japan, restricted the ability of Japanese banks to make loans denominated in foreign currencies, and tightened restrictions on yen-denominated loans to foreigners.

While credit controls are only one of many factors that influence the economic growth and stability, the use of the window-guidance type of controls for a brief period in the U.S. in 1980 indicated that it can be effective in bringing interest rates down quickly. This is almost bound to happen when banks are told that they cannot extend more than a given measure of credit in the current year (e.g., 106 percent of the amount extended last year). Those banks that are running beyond the limit and must slow down the extension of new credit, but have idle funds, must invest such funds. They will buy bonds and other interest bearing securities, bidding up the price of bonds and bidding down interest rates. That is why credit controls can be employed for a short period to bring down interest rates.

Japan has periodically used such controls over the last few decades. On the other hand, the United Kingdom and the United States have relied on restrictive monetary policy, as part of a monetarist economic belief in recent years. A few comparative economic indicators for these countries follow:

	Percentage Changes Over 12 Months			
Country	Industrial Production	Consumer Prices	Unemployment Rate	Prime Interest Rate (July 2)
United States	-8 (thru March)	+6.5 (thru May)	9.5% (thru June)	16.5%
United Kingdom	+1.25 (thru April)	+9.5 (thru May)	12.2% (thru June)	12.5%
Japan	+3 (thru April)	+2.5 (thru May)	2.4% (thru May)	6.3%

Recent Economic and Monetary Policies

Unfortunately, the harmful effects of persistent, prolonged tight money and high interest rates have never been more amply demonstrated than during the past

18 months. To test the Federal Reserve for steadfast adherence to a prescribed monetarist belief, the Reagan Administration not only admonished the Fed when it strayed from the straight and targeted path, but also pushed through legislation to cut out $750 billion in tax revenues and assure record triple-digit deficit financing.

The accomplishments under Reagan policies should be recorded. In five of the past 18 months, the prime rate was at 20 percent, in six months between 16½ and 20 percent, in two months at 15 3/4 percent, and in the last five months at 16½ percent. An upward trend has carried conventional mortgage rates from about 13½ to about 17 percent. The U.S. Treasury is paying between 14 and 15 percent on new issues of notes with maturities of two to seven years. The President did not authorize the use of credit controls to reduce interest rates.

Business bankruptcies numbered 44 percent more in 1981 than in 1980, and thus far in 1982 are 45 percent above 1981. The unemployment rate rose over the 18 months from 7.4 to 9.5 percent, leaving about 10½ million unemployed. Manufacturing capacity utilization was reduced from about 80 percent to 70 percent. And, as the high interest rates take their toll, men and machines are idled in manufacturing, in construction, in extractive industries, and in farming. And the effects have spread to other economic activities.

Monetarism and Supply-Demand Impacts on Inflation

Housing, the most interest-sensitive economic product, has been produced at a rate far below national population growth and replacement requirements for over three years. The production shortfall and tight supply have made inflation in housing prices and rents a leading inflationary element, even today.

The recession-induced reduction of income and purchasing power and forced liquidation of inventories was bound to have had some downward price effects. There were also major effects of an accompanying worldwide oil glut and the luck of some bumper crops, to slow down energy price rises and actually reduce some food prices. For a few months the Consumer Price Index leveled off and victory against inflation was being claimed. However, reduced oil production by the OPEC cartel to dry up partially the oil glut, U.S. grain sales once more to help out the Russians, higher sugar price supports, and the continuing short housing supply have reignited inflation. In May, the Consumer Price Index rose a full one percent, a 12 percent annual rate.

The sources of oil and food price inflation during the seventies has been analyzed in a book published earlier this year by Brookings Institution, entitled Commodity Prices and the New Inflation by Bosworth and Lawrence. The authors point out that food price increases were preceded by the elimination of U.S. grain reserves and accompanied by a shift in Russian policy to more imports, plus some repeated bad crop years in Russia. They also point to 1973 and 1979 oil supply disruption and panic buying by consumer countries as basic factors in the rise in oil prices, as well as institutional changes (OPEC) in worldwide oil production and marketing. The authors are pessimistic about future possibilities of achieving stability in food and energy prices. They see the need for U.S. grain and petroleum reserves, and long-range bilateral agreements on magnitudes of access with potential large purchasers of U.S. grains, and for cooperative efforts by oil consumer nations to limit imports, as necessary to limit increases in spot prices. The dismissal of serious consideration of macro-economic monetary policy as a solution for inflation from supply-demand imbalances in markets for essential commodities reflects a realism which deserves general acceptance.

Adaptation of the National Financial Apparatus

That doesn't mean that monetary and credit policies aren't needed. It points to the need for present policy changes and modification, which historically has been the way that the national financial apparatus of the country has been adapted to changed economic conditions. In 1863, to deal with the problem of economic booms and busts stemming from operations by largely unregulated, state-chartered banks that financed land speculation, the National Banking Act was passed. Thereafter, banks, under national regulation and reserve requirements, were able to provide part of the necessary financing for extended post-Civil War industrial growth. However, it became apparent from financial panics in 1873, 1893, 1903, and 1907 that the financial system did not provide a sufficiently flexible money supply. In 1913 a radical innovation, the creation of the Federal Reserve System, took place. The authorization and powers and operation of the Federal Reserve System did not come down from on high; they were another adaptation of economic institutions to changing conditions in the American economy 69 years ago.

The 1929-33 economic debacle revealed that some additional shoring up of the financial mechanism was needed. Authority for the original Regulation Q was enacted to dampen a competitive escalation of interest rates paid on deposits by banks which drove them to reach for high-rate, high-risk loans. There was also a recognition that the savings institutions engaged in residential financing should have a source of secondary credit independent of the commercial banks. Otherwise, when the latter faced a liquidity crisis, mortgage financing and housing market activity were drastically curtailed. The Federal Home Loan Bank System was established. Deposit insurance and mortgage insurance were established.

As new economic conditions evolve, new problems arise. Since World War II, there have been recurrent credit-related deep declines in residential construction followed by general economic slowdowns or recessions. Such sequences developed in 1956-57, when there were federal budget surpluses and inflation was minimal; as well as in more recent periods, such as 1974-75; and in the last few years, when there were budget deficits and inflation was high. To dampen rising economic demands and prices, prior to each of the post-war recessions, the Fed tightened overall general monetary policy to restrict increases in credit extension to business and consumers. However, the overall effect of such policies has been highly selective. Residential and local public construction suffer a significant downturn. The automobile and farming sectors also are depressed. The high unemployment and reduced income generated in these sectors has adverse effects elsewhere in the economy.

Such sequences of events have contributed to economic slowdowns or recessions that spawned declines in real gross national product, in income, and in savings. Many billions of dollars, which could have been devoted to financing capital formation and additional housing, were foregone. The succeeding cyclical upswing then finds the economy with an inflation-feeding housing shortage and without the technologically advanced plants that support increased productivity.

To get out of the repetitive pattern that rocks the country between recession and inflation, with overlapping periods when both are present, an alternative or supplement to monetary policy is needed.

Before prescribing any changes, however, there has to be an identification of changes in economic conditions that have contributed significantly to the economic and costly instability of the seventies and the eighties.

Basic Changes in Economic Conditions

A strategic change in the economy was the development of affluence and economic literacy among a significant proportion of families, as there was a doubling of median family real income (measured in dollars adjusted for price changes) between 1947 and 1979. The family income distribution at the end of about three decades was not much different than at the beginning of the period. There had been a movement toward greater equality between 1947 and 1967 when the share of total family money income going to the top 20 percent decreased from 43.0 to 40.4 percent, but that share has since climbed back to 41.6 percent in 1979-80 to add roughly $20 billion to the current annual share of the upper 20 percent.

A causal factor in that shift, in addition to more unemployment and other factors, has been the accelerating rise in the share of personal income that is interest income. As more of total income goes into interest payments, it is to be expected that the income share of total personal income going to higher-income families and households would increase. Surveys of consumer finances that have been conducted periodically over about three decades by the University of Michigan Survey Research Center have indicated that the value of financial asset holdings by families is correlated with family income levels. The correlation between interest income and family income levels is also indicated by the following data on median wage and salary income and median interest income, for families of different racial characteristics, from the Bureau of Census Current Population Reports for 1980:

Type of Family	Median Wage and Salary Income	Median Interest Income	Percent With Interest Income
All families	$20,229	$289	67
White families	20,942	308	71
Spanish-origin families	15,153	90	39
Black families	13,324	81	31

Thus, higher income families gain most from higher interest rates. Between 1950 and 1960, the percent of personal income accounted for by personal interest income rose from 4.3 to 6.2. The percentage moved up more rapidly along with interest rates in the seventies. By 1970 it had reached 8.6 percent, in 1979 it was 10.8 percent, 12.8 percent in 1981, and 13.5 percent in the first quarter of 1982.

Since real purchasing power had about doubled, many of the families in the top 20 to 40 percent of the income distribution have sufficient discretionary income for investment and/or luxury expenditures. Incidentally, the average family income in the top quintile is eight times that in the bottom quintile.

By early 1981, the relationship between the supplementation of high incomes by high interest rates and the purchase of higher priced products and services was becoming quite apparent, as reflected in the following excerpt from an article in Business Week of March 9, 1981.

> "Although high interst rates have increased the costs of consumer borrowing, they have also become an increasingly important source of income to growing numbers of consumers who put money in high-yielding money market funds or cash management accounts. Interest income as a percentage of total personal income increased by more than one-third from 1973 to 1980, going from 8.8% to 11.9%.
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> "The two-tier consumer market is 'almost the sole reason consumer spending has outpaced forecasters' estimates,' says Albert G. Matamoros, vice-president and chief economist of Armstrong World Industries Inc. The weight of the top tier of the market in determining the strength of overall consumer spending is staggering. According to economist Carol Brock Kenney of Shearson Loeb Rhoades Inc., the richest 40% of all households account for 60% of all retail sales and two-thirds of all spending on such highly discretionary durables as automobiles and color TVs."

Not to be outdone, U.S. News and World Report in its issue of March 30, 1981, carried a large collection of such items, including the following:

> "Travel by the well-to-do also is booming. Economist Elisabeth Allison of Data Resources, Inc., in Lexington, Mass., says that money owed on travel and entertainment cards, used primarily by upper-income consumers, expanded at an annual rate of nearly 40 percent in November and December."

Historical data are shown in Table 1 for five types of annual personal consumption expenditures that can be characterized as selected "discretionary income" expenditures for luxury goods and services. The five selected categories are for (1) recreation including toys, sports equipment, bikes, boats, and pleasure

TABLE 1

TOTAL AND SELECTED TYPES OF PERSONAL CONSUMPTION EXPENDITURES 1947-1981

(millions of dollars)

		Selected Discretionary Income Expenditures										
			Wheel Goods, Durable Toys, Sports Equipment, Boats and Pleasure Aircraft		"Other" Recreation[a]		Foreign Travel and Expenditures Abroad by U. S. Residents		Airline Travel		Jewelry and Watches	
YEAR	Personal Consumption Expenditures	TOTAL AMOUNT	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL
1947	161,742	3,800	955	0.6	574	0.4	785	0.5	91	0.1	1,395	0.9
1948	174,749	4,013	965	0.6	594	0.3	979	0.6	101	0.1	1,374	0.8
1949	178,135	4,125	886	0.5	594	0.3	1,231	0.7	116	0.1	1,298	0.7
1950	191,966	4,238	889	0.5	624	0.3	1,266	0.7	141	0.1	1,318	0.7
1951	207,066	4,880	897	0.4	852	0.4	1,531	0.7	188	0.1	1,412	0.7
1952	217,093	5,305	989	0.5	691	0.3	1,876	0.9	226	0.1	1,523	0.7
1953	229,665	5,972	1,090	0.5	755	0.3	2,301	1.0	266	0.1	1,560	0.7
1954	235,842	6,243	1,174	0.5	793	0.3	2,347	1.0	298	0.1	1,631	0.7
1955	253,666	6,599	1,386	0.5	887	0.3	2,534	1.0	349	0.1	1,743	0.7
1956	266,008	7,495	1,573	0.6	981	0.4	2,735	1.0	394	0.1	1,812	0.7
1957	280,409	7,976	1,720	0.6	1,086	0.4	2,908	1.0	445	0.2	1,817	0.6
1958	289,461	8,363	1,845	0.6	1,181	0.4	3,008	1.0	479	0.2	1,850	0.6
1959	310,773	9,032	2,006	0.6	1,338	0.4	3.179	1.0	589	0.2	1,920	0.6
1960	324,507	9,432	1,976	0.6	1,500	0.5	3,376	1.0	676	0.2	1,904	0.6
1961	344,997	9,558	1,944	0.6	1,653	0.5	3,325	1.0	760	0.2	1,876	0.5
1962	355,219	10,337	2,115	0.6	1,818	0.5	3,605	1.0	882	0.2	2,017	0.6
1963	374,581	11,096	2,180	0.6	2,007	0.5	3,853	1.0	924	0.2	2,132	0.6
1964	400,497	12,287	2,520	0.6	2,223	0.5	4,118	1.0	1,044	0.3	2,382	0.6
1965	430,378	13,594	2,998	0.7	2,387	0.6	4,589	1.1	1,191	0.3	2,639	0.6
1966	465,118	15,539	3,620	0.8	2,709	0.6	5,067	1.1	1,329	0.3	3,114	0.7
1967	492,262	17,838	4,055	0.8	2,957	0.6	5,860	1.2	1,582	0.3	3,354	0.7
1968	536,883	19,754	4,730	0.9	3,503	0.7	5,930	1.1	1,892	0.4	3,699	0.7
1969	581,781	22,035	5,165	0.9	4,071	0.7	6,588	1.1	2,337	0.4	3,874	0.7
1970	621,721	24,574	5,146	0.8	4,593	0.7	7,443	1.2	2,450	0.4	3,942	0.6
1971	672,242	25,555	5,573	0.8	5,102	0.8	7,948	1.2	2,694	0.4	4,238	0.6
1972	737,154	29,406	7,294	1.0	5.606	0.8	8,812	1.2	3,108	0.4	4,586	0.6
1973	811,964	32,702	8,281	1.0	6,487	0.8	9,019	1.1	3,533	0.4	5,382	0.7
1974	888,111	35,830	8,705	1.0	7,358	0.8	9,757	1.1	4,137	0.5	5,873	0.7
1975	976,449	39,050	9,724	1.0	8,273	0.8	10,280	1.1	4,375	0.4	6,398	0.7
1976	1,084,271	43,644	10,769	1.0	9,462	0.9	10,797	1.0	5,271	0.5	7,345	0.7
1977	1,205,483	48,187	12,171	1.0	10,204	0.8	11,869	1.1	6,101	0.5	7,842	0.7
1978	1,348,717	54,223	13,905	1.0	11,445	0.8	13,051	1.0	6,912	0.5	8,910	0.7
1979	1,510,838	60,657	15,699	1.0	12,951	0.9	14,254	0.9	8,076	0.5	9,677	0.6
1980	1,672,766	68,884	15,446	0.9	14,581	0.9	18,505	1.1	10,326	0.6	10,026	0.6
1981	1,858,153	73,910	16,195	0.9	16,093	0.9	17,338	0.9	12,355	0.7	11,929	0.5

[a] Consists of billiard parlors, bowling alleys, dancing, riding, shooting, skiing and swimming places; amusement devices and parks; golf courses, sightseeing buses and guides; private flying operations; and other commercial participant amusements.

SOURCE: U. S. Department of Commerce

aircraft; (2) "other recreation" including bowling alleys, riding, skiing, and swimming places; amusement parks, golf courses and sightseeing buses; (3) foreign travel and expenditures overseas; (4) airline travel; and (5) jewelry and watch expenditures. The proportion of total personal consumption expenditures accounted for by these five categories in some benchmark years were:

2.5 percent in 1947
2.9 percent in 1960
3.3 percent in 1965
3.7 percent in 1970
4.0 percent in 1975
4.1 percent in 1976
4.2 percent in 1977
4.0 percent in 1978
3.9 percent in 1979
4.1 percent in 1980
4.0 percent in 1981

The dollar amount of these expenditures in 1981 was $74 billion.

It is not only the shift in demand for end products and services that has been affected by the change in income structure but also the distribution of capital investments which has been affected and influences the productivity and stability of the economy. A current example is the production of Boeing 757s and 767s which had been stimulated by the growing air travel, but which will now be curtailed greatly as the economy goes through an adjustment. Airlines are now deferring deliveries or canceling orders.

A smaller current example, announced June 28 (in The Wall Street Journal), is the expansion of a credit line by Western Savings and Loan Association to a camp ground operator, Thousand Trails, Inc., from 25 to 50 million dollars, in return for acquiring 370,000 shares of Thousand Trails common stock, valued at $3.7 million, for cash and securities. Camp ground site rentals can bring a higher return than housing mortgages.

Changes in Investment Channels

The historical evidence clearly indicates that the evolution of increased household influence and decreased depository institution influence over loanable fund placement took place well before the existence of money market funds. One of the earliest manifestations of growing direct investment in credit market securities by households was in 1959 when individuals withdrew funds from thrift institutions and lined up in front of the New York Federal Reserve Bank to purchase "magic fives" -- U.S. Treasury notes with an interest rate of 5 percent, which was then above rates being paid on time and savings deposits.

It should be noted that the upsurges in direct investments during high interest rate periods had a depressing effect upon inflows into savings accounts in the fifties, sixties, and early seventies, before there were money market mutual funds of any significance. And the amounts of direct investment in credit market instruments rose by leaps and bounds from one tight money period to the next:

$7.8 billion in 1955

11.6 billion in 1959

17.1 billion in 1966

31.3 billion in 1969

It was inevitable that new institutions would arise to cater to the growing desire of households to shift their increased funds around in pursuit of higher yields. If it hadn't been the original type of money market funds, it would have been Merrill, Lynch or Sears, Roebuck or some other institution that responded.

The rise of the money market mutual funds simply facilitated and expanded household investment in credit market instruments, including some -- such as commercial paper -- which individuals usually had not purchased by themselves. The money market funds were not a new basic force in the economy which caused slowdowns in deposit growth or net outflows at depository institutions during tight money, high interest rate periods. They were a new form of intermediary to facilitate the household deployment of funds to higher yield investments, which had begun to develop in the fifties.

However, with the recent acceleration of the trend, the total of direct net investments in market securities plus money market funds rose from $65 billion in 1978 to $121 billion in 1979, while net inflows to time and savings accounts declined from $100 billion to $79 billion. In 1981, the total of direct investments in credit instruments plus money market funds was $151 billion versus $70 billion going into time and savings deposits.

The failure during the seventies of the thrift industry and public policy makers to focus on conditions and forces that go beyond the operation of financial institutions has been a significant factor in bringing the thrift institutions to a position of vulnerability in the eighties.

Effects of Interest Rates and Monetary Policy on Economic Activities

There were repeated demonstrations that borrowers of capital funds for nonhousing uses could pay higher rates and attract funds away from residential mortgage lending. Disintermediation of funds from S&Ls and mutal savings banks occurred during months of the 1973-74, 1979-80, and 1981-82 tight money periods. Funds flowed to higher rate investment outlets through direct investment by more educated and affluent household depositors, or through routes such as the money market funds that bought commercial bank CDs and commercial paper. Both of the latter channels provided financing for business activities.

Issuance by the thrift institutions of six month money market certificates with rates linked to Treasury bill rates provided another demonstration that they could not compete with other institutions serving nonhousing capital needs, because the home buyer (and rental) housing market was too limited at competitive market interest rates in high double-digit ranges. Nor can adjustable rate mortgages solve the problem of sharp credit related cyclical housing declines when initial mortgage interest rates are at levels beyond the reach of a large proportion of the potential housing market.

Business borrowing for investment is the strong influence that sets off and supports a cyclical upturn in interest rates that has periodically depressed housing construction as prospective home buyers are squeezed out of the market. Chart 1 shows the repeated sharp downturns in housing starts after there has been some upswing in the volume of real nonresidential fixed investment. At that stage, interest rates have been rising and the Federal Reserve usually adopts a tighter monetary policy to dampen the inflationary pressures caused by an expanding economy. Housing demand and construction decline sharply. Construction unemployment increases much more rapidly than total unemployment (Chart 2), to help lead the economy into a slowdown or recession.

Another interest-sensitive sector, automobile production, shares the roller coaster experience pattern of residential construction. Chart 3 shows the inverse relationship between automobile production and interest rates. Like residential construction, automobile production declined in 1966-67, 1969-70, 1974-75, 1979, and 1981-82.

Sharp declines, as shown in Chart 4, in manufacturing capacity utilization, to about 70 percent, occur in such supplier industries as iron and steel, and clay, glass, and stone, during periods when automobile and housing market demands decline. And even sharper related fluctuations occur in production of items used by manufacturers, such as electrical machinery. As the effects are felt throughout the economy, total manufacturing capacity utilization declines.

Criticisms of Current Monetary Policy and Recommended Remedies

Instead of addressing the changed economic conditions with a method of reestablishing some stability in financial markets and also reducing the economically injurious high level of interest rates, the response of the political and financial policy makers has been to follow a policy of increasingly embracing monetarism, even though such a policy had failed in England.

CHART 1

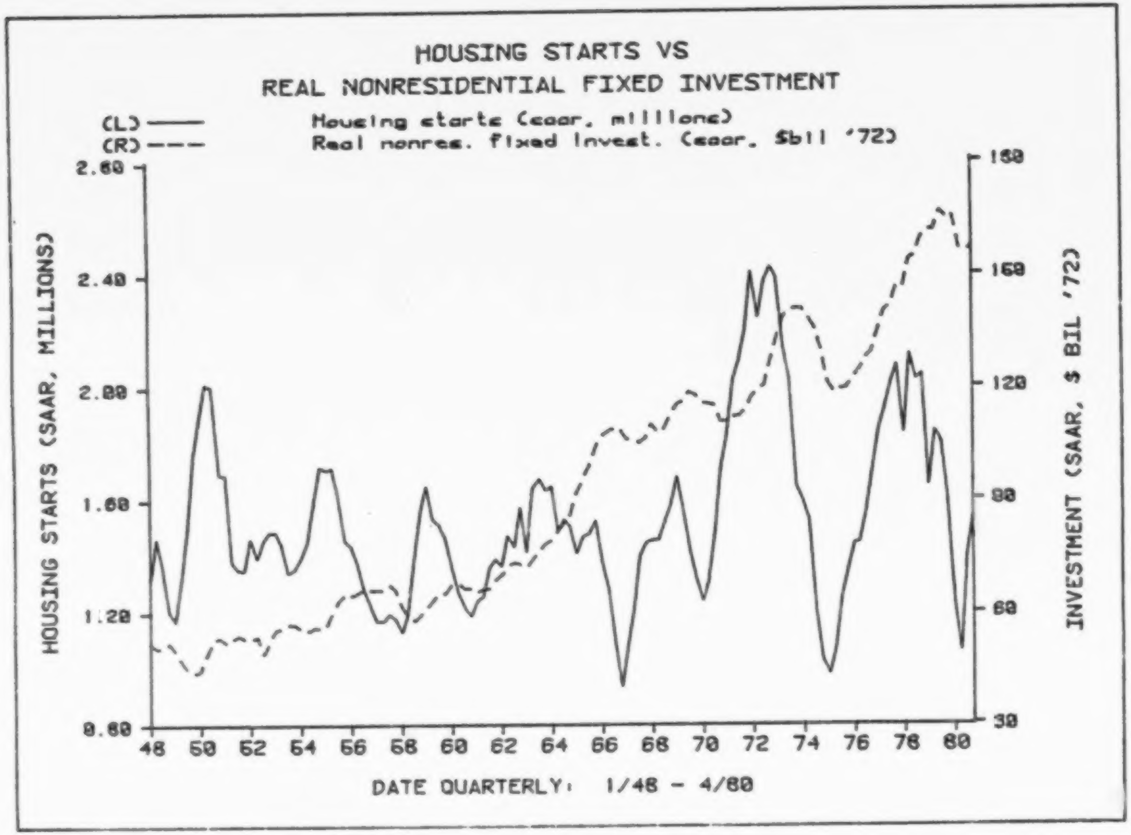

HOUSING STARTS VS
REAL NONRESIDENTIAL FIXED INVESTMENT
(L) —— Housing starts (saar, millions)
(R) - - - Real nonres. fixed invest. (saar, $bil '72)
HOUSING STARTS (SAAR, MILLIONS)
2.80
2.40
2.00
1.60
1.20
0.80
INVESTMENT (SAAR, $ BIL '72)
180
160
120
80
60
30
48
50
52
54
56
58
60
62
64
66
68
70
72
74
76
78
80
DATE QUARTERLY: 1/48 - 4/80

CHART 2

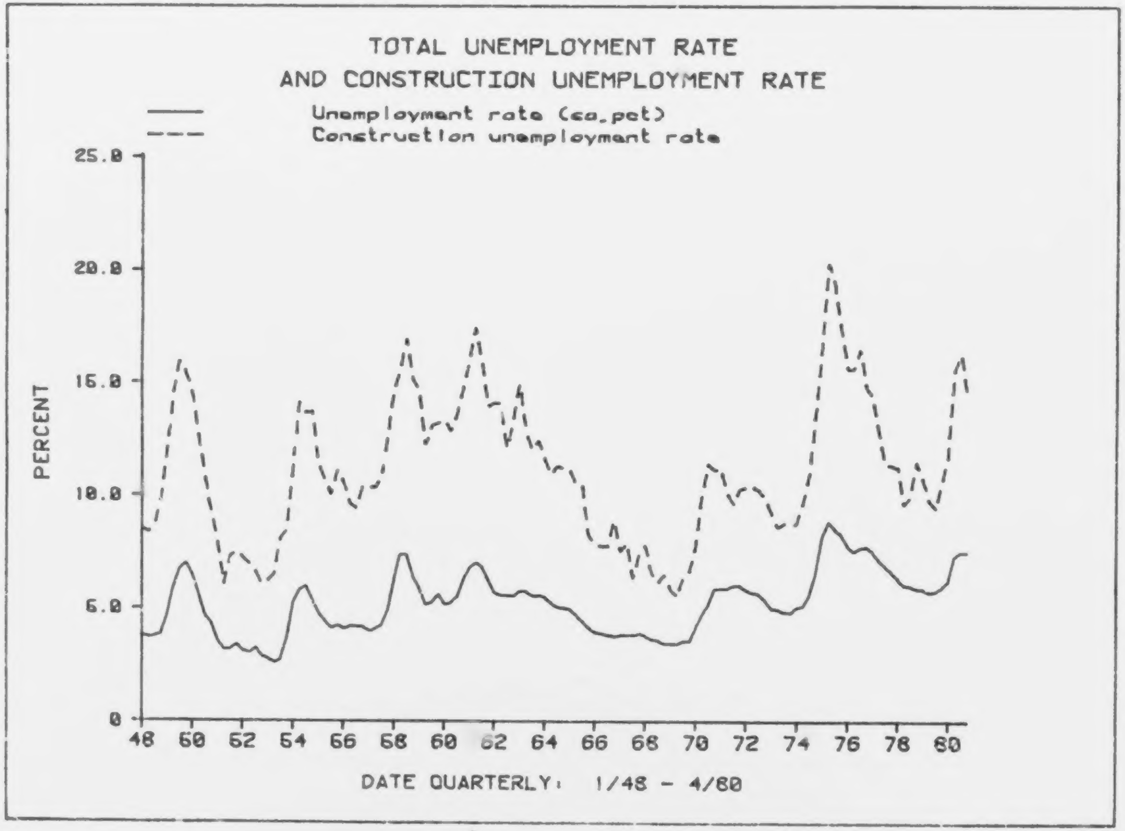

TOTAL UNEMPLOYMENT RATE
AND CONSTRUCTION UNEMPLOYMENT RATE
Unemployment rate (sa.pct)
Construction unemployment rate
PERCENT
25.0
20.0
15.0
10.0
5.0
0
48
50
52
54
56
58
60
62
64
66
68
70
72
74
76
78
80
DATE QUARTERLY: 1/48 - 4/80

CHART 3

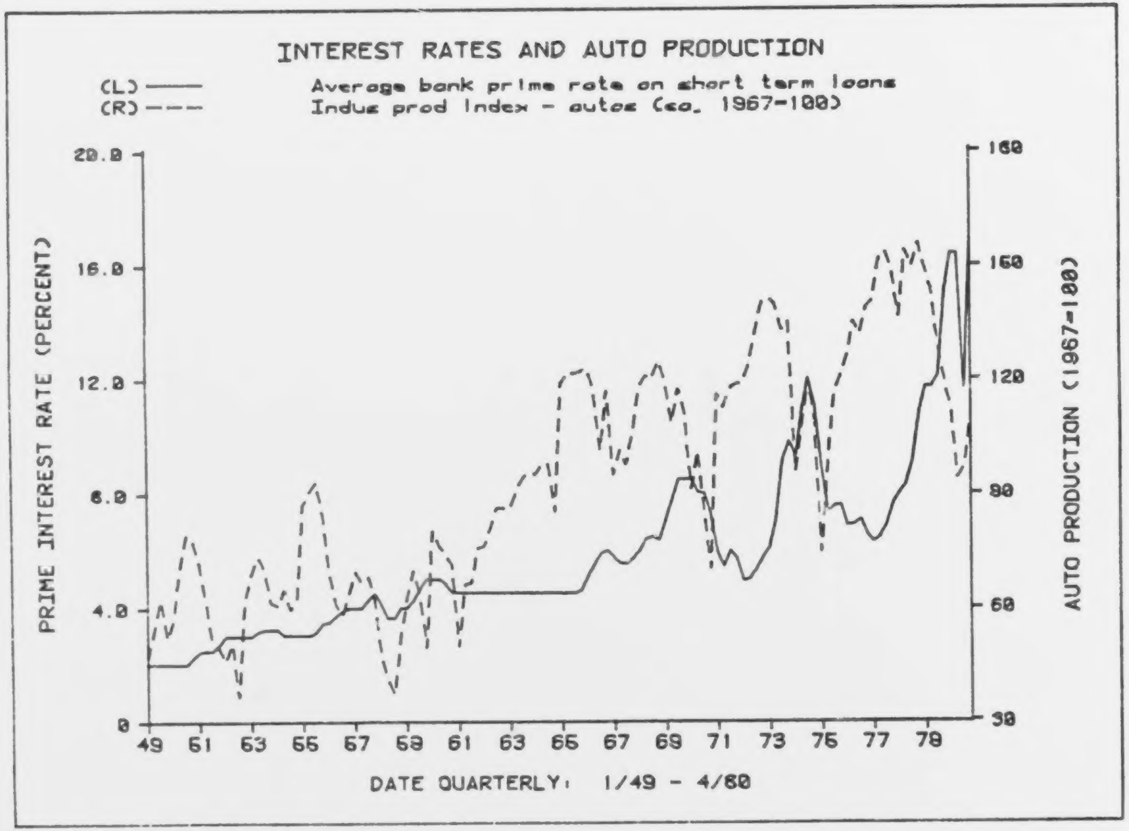
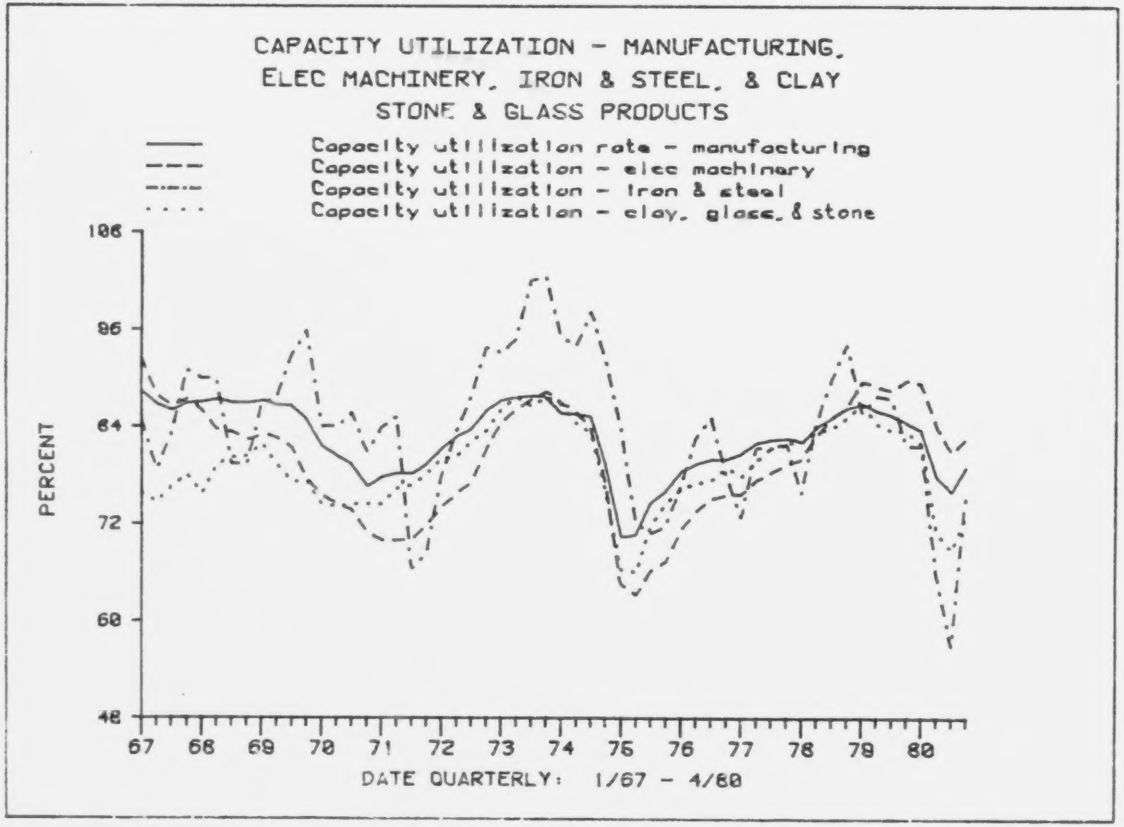

INTEREST RATES AND AUTO PRODUCTION
(L) —— Average bank prime rate on short term loans
(R) --- Indus prod index - autos (sa. 1967=100)
PRIME INTEREST RATE (PERCENT)
0
4.0
8.0
12.0
16.0
20.0
AUTO PRODUCTION (1967=100)
30
60
90
120
150
180
49 51 53 55 57 59 61 63 65 67 69 71 73 75 77 79
DATE QUARTERLY: 1/49 - 4/80

CHART 4


CAPACITY UTILIZATION - MANUFACTURING, ELEC MACHINERY, IRON & STEEL, & CLAY STONE & GLASS PRODUCTS
Capacity utilization rate - manufacturing
Capacity utilization - elec machinery
Capacity utilization - iron & steel
Capacity utilization - clay, glass, & stone
108
96
84
72
60
48
PERCENT
67
68
69
70
71
72
73
74
75
76
77
78
79
80
DATE QUARTERLY: 1/67 - 4/80

In a hearing on "Monetarism in the United States and the United Kingdom" before the Joint Economic Committee of the Congress, in October 1981, James Tobin, the 1981 Nobel Laureate in Economics, said:

> "The folly of staking credibility on particular monetary aggregates has been dramatized by events in both the U.K. and the U.S. In recent years rapid innovations in transactions technology, financial institutions, and government regulations have radically altered demands for and supplies of various bank deposits and the degrees of substitutability among them and between them, the liabilities of nonbank intermediaries, and open market paper. The Federal Reserve tried to cope with these changes by redefining monetary aggregates, an exercise which clearly illustrated the conceptual confusions and statistical ambiguities inevitably involved in drawing a sharp line between things labelled 'money' and other assets.
>
> "No sooner was the exercise completed than further innovations destroyed the continuity of meaning of the new aggregates."

Later in his testimony, in dealing with the meaning of the pursuit of the current Reagan-Volcker monetary policies, Tobin said:

> "Chairman Volcker's true message is that the Fed will stick with its disinflationary policy no matter what. No matter how long it takes, how much unemployment it takes, how deep a recession it takes, the Fed will not rescue the economy until inflation has been expunged. This is also Mrs. Thatcher's policy, and so far the wreckage of the British economy has not lessened her resolve."

Other well-known and highly respected scholars and practitioners of finance have also challenged the continued pursuit of present monetary policies and have called for modifications.

In a September 1980 article in The Banker, Robert Roosa, former Under Secretary of the Treasury, and Bruce Jackson, speaking of the 1980 credit controls, said they "had become necessary because the customary weaponry for control over the growth of bank-created money had been deployed sc mechanically during the seventies that Federal Reserve action had become in effect an accelerating force within an inflation that it was ostensibly designed to check." As they point out, each time that the Federal Reserve moved to tighten the money supply, the markets came to expect further tightening, and there was anticipatory borrowing, calling for another increase in the Federal funds rate. They also pointed out that "at any given time, close adherence to a target range (of money supply growth) would prevent the use of calculated influences on liquidity to induce offsetting changes in spending or investing behavior whenever cyclical or external factors might have produced unwanted changes in prices, capital formation, or production." There were also periods in the seventies when a rapid increase in the velocity of money use would partially offset adherence to a restrictive money supply growth target. That combination of events, incidentally, occurred in 1981.

Another distinquished financial economist, Albert Wojnilower of the First Boston Corporation, wrote a lengthy article, "The Central Role of Credit Crunches in Recent Financial History" which was published in Brookings Papers on Economic Activity, 2; 1980, in which he pointed out that, "Since the United States has subscribed to a monetary aggregates policy, the trend of monetary growth, inflation, interest rates -- and unemployment -- has been upward. ...the record as described here would suggest that only policy constraints that have a direct understandable message will be effective." He ended up by calling for limits on interest rates, loans and other controls to be used from time to time as supplements to money supply controls. Some of his specific selective tools would include outlawing floating rate credit contracts and punitive margin requirements on futures transactions. He also notes that growth limits on certain types of credit (as under March 1980 credit controls) may also hold some promise.

At the December 1981 meeting of the American Economic Association in Washington, there were two noteworthy presentations dealing with the question of monetary policy. In a paper entitled, "New Strategies for the Federal Reserve?", Anthony Solomon, President of the New York Federal Reserve Bank, noted:

> "The formulation of one-year targets for growth in money stock measures (along with an 'associated' target for bank credit) seeks to provide a coherent monetary response to endemic inflation. It reflects the perception that on the monetary side at least, a slowdown in the trend rate of money growth is a necessary condition for restoring price stability. As an approach, however, it makes no commitment to any particular theory of the underlying causes of inflation, to the possible need for other anti-inflation policies, or to the needed precision of monetary control."

Solomon also dealt at some length with the difficulties of interpreting the meaning of the divergent growth paths exhibited by different measures of the monetary stock. There is also a problem of new instruments of money and credit, he noted, some of which are not encompassed by monetary aggregates that are readily subject to monetary policy influence. Furthermore, as the defined list of instruments subject to control by monetary policy measures is broadened, new evasive innovations are invested. In discussing various alternative monetary aggregates, Solomon writes:

> "Another possibility would be to replace the money targets with a measure of credit, perhaps bank credit, credit extended by all depository institutions or some still broader credit measure. But with liability management by banks and other financial institutions, and with variable rate lending and the absence of reserve requirements on many major funding sources, the question again arises whether bank credit can be controlled."

In his concluding remarks, Solomon observed that in the current world, policy influences the economy primarily through the effects of credit cost rather than availability; that interest rates must move further in order to achieve an effect; and financial fragility seems to have increased because institutional adaptations to a floating-rate environment seems imperfect.

I would add that a floating-rate environment is a modern variation of the prevalence of unamortized balances that had to be refinanced at prevailing rates in the late twenties, and it is the entire economy which must encounter difficulty in adapting, rather than just the institutions.

Another paper presented at the American Economic Association December 1981 meeting was by Professor Benjamin Friedman of Harvard University. He had spent two years doing research and analysis to develop his findings in a paper entitled, "Time to Re-examine the Monetary Targets Framework." Some of his conclusions were similar to those of previously mentioned authors. Thus, he points to the destabilizing, inflationary effects of reduced oil and grain supplies in the seventies, which could not be countered by restricting aggregate demand through tight money (as do Bosworth and Lawrence). He joins Solomon in pointing to redefinitions of the money aggregates as evidences of difficulty in measuring the money growth, and Friedman emphasizes that any arbitrarily chosen monetary aggregate does not necessarily correspond to what matters for gauging the effects of monetary policy upon the economy. Professor Friedman also cites data of recent periods which show that the relationship between money and prices has not held, that financial market behavior is no more stable or predictable than real spending behavior --especially when there are massive shifts into or out of NOW accounts.

Benjamin Friedman, therefore, searched for an alternative or supplement to the monetary supply that the Federal Reserve could influence. He found that the "aggregate outstanding indebtedness of all nonfinancial borrowers" in the U.S. has just as close and stable a relationship to total nonfinancial activity as the money supply. He proposes that the Federal Reserve, in trying to exercise its function of promoting economic stability, should adopt a two-target approach: the money supply growth and credit growth, as already required by the Humphrey-Hawkins Act. In order to influence both targets, the Fed would provide more or less bank reserve funds -- a difficult task.

(It should be noted that in fulfillment of the Humphrey-Hawkins credit target requirement, the Federal Reserve Board sets a bank credit growth target "corresponding target range" to that of M-3, the broad monetary aggregate which includes commercial bank securities repurchase agreements and balances of money market mutual funds -- which are not subject to great control by present monetary policy tools.)

Another articulate critic of the protracted pursuit of a monetarist policy is Henry Kaufman, the noted Wall Street practitioner of economics with Salomon Brothers. He expressed his views in an article entitled, "Danger: Too Much Turbulence," in the May-June 1982 issue of Challenge. In the current dangerous, high debt situation he highlights the enormous credit liabilities of households, governments, and businesses; the low level of corporate liquidity; increased federal demands in credit markets; highly leveraged financial institutions; and high business vulnerability due to excessive short-term business financing.

Given the foregoing conditions, Kaufman identifies four worrisome interest rate aspects: (1) extraordinarily high rates after a year of recession; (2) unprecedented volatility of rates; (3) frequent negative yield curves, causing financial institutions to shift to variable rate, "spread banking"; and (4) high "real interest rates," imposing an increasing burden upon business cash flow.

Kaufman notes (along with others) that monetarism has encouraged financial innovations to escape more costly monetary regulation, necessitating catch-up redefinitions of the money supply by the Federal Reserve. He then points to specific monetary policy shortcomings: (1) no credit restraints other than interest rates; (2) the absence of long periods of positively sloped yield curves that helped in previous recessions and recoveries; (3) with the sole restraint of interest rates, the credit system cannot be reliquified during business contractions and early recoveries; and (4) "spread banking," shifting risk of interst rate changes to borrowers through variable rate loans, eliminates an important factor in prudent fiduciary behavior by lenders.

Believing that a brand new approach to monetary policy is needed, Kaufman recommends that in lieu of present monetary targets, there should be substituted the total of credit market instruments, deposits, and currency held by private domestic nonfinancial investors because such a target provides a closer link with total GNP. In addition, to restore fiduciary responsibility all major financial institutions should have to maintain varying capital ratios, and the proliferation of short-term debt has to be curbed. Toward these ends, Kaufman recommends certain selective credit regulations: (1) phase out all lines of credit supporting the issuance of commercial paper; (2) require commercial banks to maintain capital ratios on contractual unused lines of credit; (3) impose reserve requirements on money market funds; and (4) give the Federal Reserve discretion to regulate margin requirements in the financial futures and options markets.

Credit Control Authority is Needed as a Periodic Remedy

As indicated in the preceding summary, an increasing number of authoritative voices have found the present aggregate monetarist policies to be ineffective in fighting inflation stemming from supply-demand imbalances in sectors such as food and energy. Furthermore, it has been noted that the prolonged high-interest rate environment, which is the cutting edge of the present monetary policy -- and is likely to be prolonged further in the two-tiered U.S. economy -- poses dangers of a financial collapse among financial institutions and nonfinancial business corporations which can drag the entire economy into a deeper, longer depression.

The financial and credit market analysts and practitioners end up searching, groping and suggesting alternatives or supplements to present monetary policy. Among these various suggestions, there are some specifics for "Fed" authority for maintenance of bank capital ratios against credit commitments, outlawing floating rate credit contracts and establishing punitive margin requirements on certain types of futures investments. On a broader scale, however, there are three specific suggestions and recommendations for having broad credit aggregate targets as substitutes for or supplements to the present monetary policy. However, two of the three authors do not go into the necessary implementation to achieve such credit targets, and the third (Anthony Solomon) raises the question whether bank credit can be controlled. A fourth analyst (Albert Wojnilower) notes in a footnote that "Growth limits for certain types of credit (a la March 14, 1980) may also have some promise."

On July 6, The Wall Street Journal published the end-of-1982 interest rate forecasts of 15 economists from large banks and economic consulting firms. Eleven of them had had prime rate forecasts ranging from 15 to 16½ percent, only one was as low as 14 percent, and the other three forecasts were between 14 and 15. Such interest rates would not provide much relief to businesses or governments overburdened with high debt service obligations. They would not permit a revival of the home building or auto manufacturing and their supplier industries. They would assure that many more farmers would lose their farms and unemployed or underemployed workers, especially those with variable rate loans, would lose their homes because they cannot continue to meet high interest costs. They would push many financial institutions and corporations over the brink of bankruptcy, and create a danger of prolonged economic depression.

H.R. 6124 is needed to retain and strengthen authority that can bring down interest rates and restore noninflationary economic growth. In addition to extending the Credit Control Act of 1969 beyond its expiration date of June 30, 1982, amendments would clarify that the credit control authority could be used to bring down interest rates in order to fight high unemployment and recession, as well as to fight inflation, to preclude the use of credit for unproductive uses, such as corporate takeovers, and to assure greater credit availability for productive purposes. Authority for credit control implementation is essential to have an alternative or supplement to monetary policy. The Federal Reserve policy of tight money and high interest rates to combat inflation has proven ineffective time and again. It is ineffective because the high interest rates directly and indirectly add to inflation as they are rolled into the prices of goods and services, as well as required on mortgage and consumer credit loans. It has become more ineffective because a two-tiered economy has developed which maintains certain economic sectors supported by discretionary incomes, that are kept at high levels by high interest rates which are kept in effect for a long time. The end result is serious recession and a potential prolonged depression.

Credit control authority is needed, so that it can be used to help restore economic recovery with stability and help the country become more productive and internationally competitive. The President should have the authority.

For all of the foregoing reasons, the AFL-CIO urges you to approve H.R. 6124.

Chairman ANNUNZIO. Thank you very much, Mr. Schechter, for an outstanding statement.

Our next witness, Mr. Sheldon Friedman, research director of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America.

STATEMENT OF SHELDON FRIEDMAN, RESEARCH DIRECTOR, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA-UAW

Mr. FRIEDMAN. Thank you, Mr. Chairman. I appreciate this opportunity to present the UAW's views on credit controls and monetary policy.

We strongly support H.R. 6124, which would reestablish standby credit control authority, and we are especially pleased with the features of this bill, which would include recession and unemployment triggers as well as provide credit targeting provisions.

The monetarist doctrine that has been pursued by our Federal Reserve Board since October 1979, and more recently with the strong encouragement of the Reagan administration, has been an unmitigated disaster.

It is, without doubt, the greatest single factor underlying what has become the worst recession since the Great Depression. It has led to the highest and most erratic interest rates in our Nation's history, with devastating consequences for the economy. Right now, we have a real prime interest rate in excess of 11 percent.

We urge rejection of this monetarist doctrine and refocusing of monetary policy to provide adequate credit to allow the economy to expand and grow, and credit that is available at the reasonable interest rates.

Credit controls are a necessary tool in conjunction with this refocusing of monetary policy. It would be extremely important for the Federal Reserve Board to have standby authority to restrict access to credit for nonproductive and speculative applications, and to direct access to such productive applications as car loans at affordable interest rates.

The cost of monetarism to our economy is incalculable. It has been estimated that in order to cut inflation by only 1 percent via monetarist recession, the loss to the economy is a staggering $200 billion in GNP. Even that is an ephemeral gain as interest rates drive up costs, and the slump that results cuts supply, leading to further inflation down the road.

Workers have been the chief victim of monetarism. We face the worst unemployment since the Great Depression. If you count in the discouraged workers and those workers who are involuntarily working part-time, but would prefer to be working full-time, we have some 17.4 million unemployed in this country today, an incredible 15.6 percent of the potential labor force.

The AFL-CIO has estimated that some 30 million American workers will face unemployment lines sometime during 1982. Of our Nation's manufacturing capacity, 30 percent stands idle. In auto, it is a staggering 46 percent, and in steel, 51 percent, the highest such figure ever recorded.

Mortgage delinquencies are at a record rate; bankruptcies are the highest since the 1930's, and not only small but also some quite large and well-known corporations are threatened.

Capital spending is sluggish at best. Those corporations that have any cash are investing it in high interest-bearing, short-term money market investments rather than committing funds to long-term productive investments.

The impact of this devastating monetarist experiment has been very, very unfair on particular sectors of our economy that are vitally dependent on credit, and doubly unfair on those sectors that are both credit-sensitive and exposed to international trade, such as the automobile industry. The punishingly high interest rates have not only had a direct impact on those industries, but they have adversely affected the international trade situation through the artificial strengthening of the dollar that has resulted from our terribly high interest rates, weakening our exports and giving stimulus to imports.

In auto, we are in the 40th month of a disastrous slump without precedent since the Great Depression, and although that has many causes, including skyrocketing imports, among the most serious and significant causes are tight money and skyrocketing, sky-high interest rates.

Looking at car sales, since 1978, which was the last really good year we had, domestic car sales in the year 1981 were down 32 percent to the lowest level in 20 years. We sold only some 6.2 million domestic-made cars in this country last year.

With respect to trucks, the situation is even worse. The downturn was 58 percent in 1981, compared with 1978.

With respect to cars, we face, unbelievably enough, an even further downturn in 1982. Nobody believed the situation could get worse in the automobile market in 1982 than it was in 1981, but, in fact, it has gotten substantially worse. For the month of June, the latest figures we have, there was an incredible 13-percent decline in domestic car sales, even below the terribly depressed sales figures of June 1981.

It is very clear that interest rates have been a significant factor in the desperate situation that the auto industry and auto workers find themselves in.

I would like to illustrate this for you with respect to the interest costs to finance a new car purchase. If you consider a $6,500 car note over a 4-year period, the difference between a 12-percent rate of interest on that note and a 16½ percent rate, which is the current rate, is nearly $1,000 over the 4 years of the note—an increase in interest expense of 82 percent.

It costs 82 percent more in interest expenses over the life of that note with interest rates at 16½, compared to interest rates at 12.

As you noted in your opening remarks, Mr. Chairman, General Motors' interest rate in the incentive plan introduced April 1 had a very significant effect on the market—showing yet again evidence of the strong link between interest rates and motor vehicle sales. In March, before they introduced their 12.8-percent financing plan, GM sales were a dismal 20 percent below March 1981.

The plan then became effective on April 1, and in the last 20 days of April, sales picked up 7 percent over the year-earlier figure, and in the month of May, sales were a full 22 percent ahead of May 1981.

Then on May 31, the program expired, and June sales plummeted 17 percent below the level of June of 1981.

Further evidence of the interest and credit sensitivity of auto purchases is provided by the University of Michigan survey of consumers, which found that one-third of all consumers were postponing purchases, mainly of homes and cars.

As a result of the incredible depression conditions in auto, we have staggering unemployment, which amounts right now to 220,000 workers on indefinite layoff at the original equipment car manufacturers—GM, Ford, VW, Chrysler, American Motors. Production-worker employment in the industry has declined by approximately one-third since July of 1979. If you throw in white-collar workers and the supplier workers who have been affected by the downturn in auto, we estimate that there has been a loss of approximately one million jobs related to the auto crisis, including steel, rubber, aluminum, et cetera.

The financial crunch has had a tremendous impact on the corporations' balance sheet. The Big Four domestic auto makers have sustained a cumulative loss of $5.6 billion since 1980. Their interest expenses and debts have gone through the roof. Capital spending, meanwhile, has been trimmed back radically. At the beginning of this year, it was projected that capital spending in the first half by the auto makers would total some $12.2 billion. Conditions have gotten so bad they have not been able to finance it, and they have trimmed that way back to $9.2 billion and anticipate a further drop of $8.2 billion capital spending in the second half of this year. We are mortgaging the future of this industry, and with it the jobs of many more thousands of our members.

There are numerous suppliers to our industry and some 3,700 auto dealers who have gone out of business since early 1979—15 percent of the total dealer body.

The catastrophic impact of high interest rates and tight money has not been limited to auto. Other UAW industries have been very greatly affected, farm equipment being a leading case in point. Farmers have been squeezed by depressed farm income and skyrocketing interest rates.

Equipment purchases have been deferred by farmers to the extent that their repair bills now cost them half as much as their new equipment purchases, an unprecedented ratio.

If you look at the decline in unit sales for 1981 versus 1979, in the case of tractors, down 25 percent; combines, 17 percent; balers down 47 percent; harvesters down 39 percent. That decline is continuing so far in 1982: Tractor sales are off 20 percent, compared with the same months of 1981; combines down 40 percent; balers down 42 percent; and harvesters down 27 percent.

With respect to construction equipment, an industry trade association recently predicted double-digit unit sales declines in all major categories of construction equipment in the year 1982, compared with 1981. In the first quarter of 1982, unit shipments were down a staggering 56 percent in the construction equipment industry, compared with the first quarter of 1979, the last really strong year.

In terms of jobs, we have seen production worker employment in construction equipment plummet a staggering 33 percent between April of 1979 and April of 1982. In the farm equipment industry, production worker employment has dropped 47 percent. We are talking here about a combined loss of some 93,000 production-worker jobs. The heavy truck industry is in disastrous straits, with some 50 percent fewer unit shipments to date in 1982 than in the comparable months of 1979.

The repercussions have been catastrophic. If you look, for example, at the International Harvester Corp., they lost some $1.5 billion in the last 2½ years, and nearly went over the brink into bankruptcy. The fears have receded a bit in the last few weeks and months in the wake of top-management changes, but nevertheless, at this point in time, one-half of that corporation's 35,000 U.S. employees are laid off.

In aircraft industry—another UAW-organized industry—we have been hit, as Mr. Schechter described earlier, by the squeeze between recession and tight money that has affected the airlines, and we are not enjoying very good job prospects there.

So, in conclusion, Mr. Chairman, it is clear that monetarism has been a disaster for our economy and especially for workers who have been its chief victims.

It is a major cause of the economic slump. It has been one of the leading factors that has propelled much of America's basic industry, quite literally to its knees.

Obviously, we hope for an economic recovery, but in point of fact, there is substantial risk of continued economic calamity. Even if we have recovery, there is great fear that it will be nipped in the bud by high interest rates and tight monetary policy. Instead of monetarism, we need adequate credit, affordable interest rates, and in connection with achieving that objective, credit controls are an important tool to channel credit to productive uses.

We urge enactment of H.R. 6124.

Thank you, Mr. Chairman.

[Mr. Friedman's prepared statement, on behalf of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America, follows:]

STATEMENT OF
SHELDON FRIEDMAN, RESEARCH DIRECTOR, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA
ON
EXTENDING THE CREDIT CONTROL ACT
BEFORE THE
HOUSE SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE

July 14, 1982

Thank you for this opportunity to present the UAW's views on credit controls and monetary policy.

The UAW supports H.R. 6124, which would reestablish the stand-by authority to restrict credit granted to the President by the Credit Control Act of 1969. We also agree with strengthening the Act by including high unemployment and recession (in addition to inflation) as possible "triggers" to credit controls, prescribing limitations to credit for nonproductive purposes, and channeling credit to productive uses.

Pursuit of monetarism by the Federal Reserve Board during the last three years has perhaps been the most significant factor in propelling the country into its worst recession in 40 years. If continued, these policies of tight money and their sequel of ruinous high interest rates will straightjacket the economy. Prosperity cannot return unless monetarism is abandoned and growth and employment replace disinflation as goals of monetary policy. Presidential authority to establish credit controls and direct the Federal Reserve Board to allocate credit so that key but financially starved sectors are stimulated and speculative ventures are discouraged is essential to a flexible and responsive monetary policy.

The recession is taking its grim toll on many groups, but American workers are paying the steepest price: the number of jobless, discouraged, and underemployed have reached post-Depression highs. As of last count, 17.4 million people — or 15.6 percent of the country's potential labor force — were unable to find full-time work. Millions of those holding a job are fearful of what the future holds.

Not only has monetarism extracted a terrible price; its impact has been most unfairly and burdensomely distributed. Sectors of the economy most sensitive to credit market conditions have borne the brunt of the monetarists' assault. In particular, the auto industry and its suppliers have been in a depression for well over three years. While soaring imports and an uncertain energy outlook have been important factors in this mammoth industrial catastrophe, much of the responsibility for it rests with tight monetary policies and unprecedentedly high interest rates.

Recent evidence underscores the sensitivity of auto sales to interest rates. Starting last April 1, the General Motors Corporation offered to finance new car and truck purchases at 12.8 percent. Sales of GM cars, which in March had slumped 20 percent from the same month in 1981, chalked up a 7 percent increase in the last 20 days of April followed by a hefty 22 percent in May with respect to the comparable periods a year earlier. When the sales incentive program expired at the end of May, sales in June went back to a 17 percent decline relative to 1981. Further evidence of interest rate sensitivity is furnished by the University of Michigan survey of consumers: one-third of all households reported postponing purchases, chiefly homes and autos, because of high interest rates. Those families indicated that the highest rate they would be willing to pay for credit was 12 percent, several points below the current average finance rate for auto credit.

Compared with the first half of 1979, the industry's last healthy period, first half 1982 sales of domestic cars and trucks were down 34 percent. And the crisis shows no signs of abating:

o Relative to the same (depressed) period in 1981, 1982 domestic car and truck sales through June fell 5 percent;

o Production in the first half of 1982 barely exceeded 2.6 million cars, down 6 percent from 1981's low level;

- The mid June domestic car sales rate of 4.1 million (seasonally adjusted, annualized) is the lowest of the current recession.

In terms of jobs, the statistics are staggering:

- At the car assembly companies alone, more than three years after the current crisis began, over 220,000 workers are on indefinite layoff;
- Production worker employment in the motor vehicle industry, according to the Bureau of Labor Statistics (BLS), has declined by almost one-third since July 1979;
- Including the loss of supplier and other auto-related manufacturing jobs, the decline in employment has exceeded one million.

Basic metalworking industries outside of auto which employ large numbers of UAW members have also been dealt a terrible blow by the Fed's iron fist. As potential buyers of heavy machinery and equipment have lost access to credit, or have been able to obtain it only at exorbitant rates, sales and employment in these industries have been pummeled. And with worsening business conditions, most customary buyers of such equipment have increasingly found that they have more than ample capacity to handle their shrunken volume of business. Yet another perverse offshoot of high interest rates has been the allocation of money -- by Corporations which still enjoy some liquidity -- away from productive investments and into short-term instruments such as money market funds and certificates of deposits.

Sales of construction machinery equipment, which UAW members build, have been devastated by the slump in construction: unit shipments were down 56 percent in the first quarter of 1982 from the first quarter of 1979. Employment has dropped apace: more than 30,000 workers — over one-fourth of the total workforce — have lost their jobs. The demand for farm equipment has plummeted. Unit shipments fell 50 percent from the first quarter of 1979 to the first quarter of 1982, putting 38,500 workers (34 percent of the workforce) on the street. Sales of medium and heavy trucks in the first quarter of 1982 were over 50 percent lower than in the same period 3 years ago. The manufacture of commercial aircraft — another industry where thousands of our members work — has also been hit, due to the plight of major airlines caught in the squeeze between recession and tight money.

Beyond the direct impact of tight money, to the extent that high interest rates contributed to an unwarranted surge in the value of the dollar, there has been a further depressing effect on domestic industries as imports have been stimulated and U.S. exports have become less competitive in world markets.

The crisis is placing an unprecedented strain on corporate finances throughout much of American industry. Since 1980, and including the first quarter of 1982, the four domestic auto companies have sustained a combined loss of $5.6 billion. A look into other UAW-organized industries reveals the situation to be just as serious. International Harvester, a leading manufacturer of heavy duty trucks and farm machinery, has lost $1.5 billion in the 2½ years ended last April, triggering fears of bankruptcy. Although those fears have receded somewhat in the wake of top management changes, the future of the company, its 35,000 employees (about half of whom are now laid off) and 20,000 retirees heavily depends on an improved economy and stronger sales — both of which are in turn endangered by high interest rates.

Countless parts supplier companies have also found themselves deeply in the red. Especially among small to medium-sized companies, many are teetering on the brink of bankruptcy. For them, the downward spiral of falling sales, greater indebtedness, and soaring interest payments often ends abruptly as banks refuse to finance them any longer. Thousands of UAW members have lost their jobs as these smaller plants have gone under.

Auto dealers, clobbered by high interest rates on two fronts — the financing of their inventory and consumer resistance — have closed their doors at an unprecedented rate. Between January 1979 and April 1982, 3,653 dealerships — over 15 percent of the end 1978 total — went out of business.

Weak sales, excess capacity — 30 percent in manufacturing and almost 45 percent in motor vehicles — low profits or outright losses, and the forbiddingly high cost of credit threaten to permanently damage auto and other basic manufacturing industries. Despite last summer's massive tax cut, a recent official survey reported a 2.4 percent real drop in 1982 spending on plant and equipment. The motor vehicle sector, which in the fourth quarter of 1981 announced plans to spend $12.2 billion in new investment in the first half of 1982, by late April had scaled that back to $9.2 billion and was planning a further drop, to $8.2 billion, for the second half of the year. As their investment plans are postponed or permanently scaled back, the future competitiveness of American basic industry is at stake — and so are the hundreds of thousands of jobs it provides.

Indeed, a stagnant economy, rising joblessness, and snowballing bankruptcies can only be followed by sluggish productivity growth, more stagnation, and increasing risk of even worse economic catastrophe. This frightening situation must be turned around, and turned around fast. Though it will not by itself be sufficient to turn the economy around, monetary policy holds a vital key to a strong and lasting upturn — through lower interest rates and adequate credit availability.

Credit controls, if properly implemented, can be a valuable and viable supplementary tool to bring credit within the reach of the nation's beleaguered manufacturers. In part, that would be done by curbing the diversion of funds to nonproductive uses such as those corporate takeovers or mergers which serve no useful public purpose, and financing of speculation. In addition, the Federal Reserve could be directed to make special efforts to maintain affordable credit flows for home buyers, car buyers, farmers, and for those activities that are closely tied to our flagging industrial base.

In conclusion, monetarism has been a disaster for the American economy and for the millions of working people who are its chief victims. It is the major cause of the worst recession since the Great Depression, and has contributed significantly to bringing much of America's basic industry, including auto, quite literally to its knees. Though hope springs eternal that recovery is imminent, the risk that even more serious economic trouble looms ahead cannot be discounted. Even if recovery comes, continuation of monetarism and sky-high interest rates threaten to nip it in the bud.

While there is no easy cure for our economic ills, the nation's monetary authorities must turn their attention away from monetarism and toward providing adequate credit at affordable interest rates so the economy can once again expand and grow. In achieving this aim, credit control authority of the kind provided in H.R. 6124 is an important policy tool. The UAW urges enactment of this vital legislation.

Thank you.

* * *

Chairman ANNUNZIO. Thank you, Mr. Friedman, for an excellent statement.

Thank you for bringing before the subcommittee all of the other industries that are affected by this disaster that we find ourselves in today.

Our next witness is also a former Chicagoan. He is the executive vice president of the National Association of Home Builders, and, Mr. Stahl, I would ask you, when you lived in Chicago, where did you live?

Mr. STAHL. I lived in the 39th Ward and in the 11th Congressional District.

Chairman ANNUNZIO. I wanted you to say that.

You may proceed in your own manner.

STATEMENT OF DAVE STAHL, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. STAHL. My name is Dave Stahl. I am executive vice president of the National Association of Home Builders.

I have been away from that great town of Chicago for 9 years, but it is always a pleasure to be with people from my hometown.

NAHB is a trade association of the Nation's homebuilding industry. I speak today representing the more than 111,000 members of NAHB, consisting of homebuilders, subcontractors, suppliers and many other facets of the homebuilding industry.

I would like to congratulate the chairman of this subcommittee for holding these timely hearings on whether to continue the standby Presidential authority to impose credit controls. With interest rates continuing at record high levels, all potential methods of dealing with inflation and interest rates should be carefully examined.

Mr. Chairman, it is customary for our association, in testimony before the Congress, to present the facts and figures relating to the state of our industry. At the beginning of this year, I had hoped that by July 1982, the description of the homebuilding industry would have included some optimism and signs of recovery. Tragically, this is not the case. The numbers in my prepared statement show the stark reality of a continued housing depression.

Your remarks, Mr. Chairman, and those of Chairman St Germain, and those of Congressman Weaver, summarize the state of our industry as well as anything I could say, and I will skip over all those numbers.

The numbers paint a bleak picture for the homebuilding industry. But today, every other business dependent on affordable credit for survival has a similar story.

NAHB supports H.R. 6124, introduced by Representative St Germain, chairman of the Banking Committee, which would extend the Credit Control Act and improve the President's ability to deal with high interest rates and unemployment. As an industry that has been the continued victim of high interest rates, we cannot, in good conscience, reject any standby Presidential authority to deal with this problem.

As the members of this subcommittee are well aware, we fought long and hard this year for an emergency housing and employment stimulus program to revive our industry and to generate an overall economic recovery. We believe this stimulation is an appropriate role for the Government.

One of the principal arguments used by opponents of the emergency housing program was that it was unnecessary, since the overall budget would reduce interest rates. But what happened once the budget passed? Interest rates began an upward climb, and political leaders and economists admitted the budget really would not bring down interest rates.

Furthermore, the administration is now indicating that the recession may have bottomed out and a recovery could be in the works. But according to several economists, this recovery won't include the housing industry or others dependent on affordable credit, as all recoveries have in the past.

Although the administration's midyear economic forecast calls for a resumption of economic growth, many private economists expect a continued recession. The reason given by the private economists is the continuation of high interest rates. Long-term interest rates, on which our industry is dependent, are not expected to drop this year. In fact, conventional mortgage rates have increased from 15.4 percent to 17.3 percent in the last 6 months.

What this means for the homebuilders that helped build up this Nation's economy, is that there won't be an economic recovery this year. What this means for potential home buyers is that there will be no light at the end of the tunnel this year.

From my discussions with homebuilders and potential home buyers alike, I find a serious lack of confidence concerning the future of our economy. People are worried whether they will be the next victim of unemployment and whether they can continue to pay their bills. The last thing someone is going to do with concerns such as these is make the largest single purchase of a lifetime, such as a new home. With nearly 10 percent of our workforce unemployed, and expectations such as these, a full economic recovery cannot and will not occur.

Those who argue against credit controls as interference in the credit markets ignore or are unconcerned with the difficulties that small businesses and consumers have in competing in the credit markets. The big borrowers, and the Federal Government is the biggest, continue to pay high interest rates regardless of their cost or impact on their budgets.

Corporations are able to tie up billions of dollars in loan commitments, which may never be used or are used simply to acquire another corporation. At the same time, the small borrower, who simply cannot afford to pay the market interest rates, is squeezed out of the market and ultimately out of business.

A monetary or credit policy which allows large businesses easy access to credit markets but at the same time chokes off the financing available for interest-sensitive small businesses, is neither equitable nor efficient. The system concentrates credit on those areas which contribute least to productivity. It is a system which rewards borrowers who are big and punishes those who are small.

H.R. 6214 would "prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers and otherwise insure the availability of credit for productive and necessary purposes." With this authority, the administration could still pursue a restrictive monetary policy but could encourage job creation, productivity, and the provision of needed housing by redirecting credit away from nonproductive uses.

Those who oppose credit controls usually argue that the free market is the appropriate and best mechanism for allocating credit. We disagree with this viewpoint and suggest that in times of recession, the President and the Federal Reserve Board can and should make value judgments about what is important and what is less important or of no importance to this society.

If owners of casinos, abortion clinics, and massage parlors can afford to pay 25 percent for mortgage money, we don't think the American homeowners should be cut out of the market because they cannot afford to compete with these and other questionable uses.

The whole Federal budget is a collection of value judgments about what is important to this society and what is less important or not important at all to this society. There are times when the Government can and should intervene in the private granting of credit to make similar value judgments.

This legislation correctly reserves these standby powers for the President alone. We believe the President must make the final decision to implement such powers. The legislation also requires the President to work with the Federal Reserve in implementing any credit controls. I would hope this would assure that extensive communication between the President and the Chairman of the Fed occurred before any controls were activated. These past 2 years have been a good indication that much more cooperation is needed between our fiscal and monetary policymakers.

In light of the continued levels of high interest rates which are preventing a full economic recovery and the seeming inability of Government and business to reduce rates, the standby powers embodied in H.R. 6124 may be the only short-term approach to reducing high interest rates. A continued wait for a long-term recovery will guarantee further bankruptcies, unemployment, and widening budget deficits.

I urge this subcommittee and the entire Congress to act to extend the Credit Control Act with the added flexibility embodied in H.R. 6124 to allow the President the standby authority to deal promptly with high interest rates. I thank you for the opportunity to present our views on this subject, and would be happy to answer any questions.

Let me pick up on another point which has already been made here today.

I had the privilege in May to attend my son's graduation from Annapolis from the U.S. Naval Academy.

Secretary Weinberger spoke to this graduating class and made a really articulate and inspiring charge to these young officers about their role in preserving the peace all over the world. But, of course, Secretary Weinberger wants more tanks, aircraft carriers, and missiles to keep this peace.

My son is down in Pensacola, Fla., learning to fly jets. I hope he does not have to use these weapons he is learning about, but if he does, I want him to have the best tools available in the world.

The President should have the best tools available to deal with the economy. Credit controls are one of these tools.

Thank you for inviting me to be here.

[Mr. Stahl's prepared statement, on behalf of the National Association of Home Builders, follows:]

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

before the

SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

UNITED STATES HOUSE OF REPRESENTATIVES

ON

EXTENSION OF THE CREDIT CONTROL ACT

JULY 14, 1982

Mr. Chairman and Members of the Subcommittee:

My name is Dave Stahl, and I am Executive Vice President of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry. I speak today representing the more than 111,000 members of NAHB, consisting of home builders, subcontractors, suppliers and many other facets of the homebuilding industry. Accompanying me today are Jim Schuyler, NAHB Vice President and Legislative Counsel and Joe McGuire, Director of Regulatory Affairs.

I would like to congratulate the Chairman of this Subcommittee for holding these timely hearings on whether to continue the standby Presidential authority to impose credit controls. With interest rates continuing at record high levels, all potential methods of dealing with inflation and interest rates should be carefully examined.

Mr. Chairman, it is customary for our association in testimony before the Congress to present the facts and figures relating to the state of our industry. At the beginning of this year, I had hoped that by July 1982, the description of the homebuilding industry would have included some optimism and signs of recovery. Sadly, this is not the case. The numbers in my prepared statement show the stark reality of a continued housing depression.

HOUSING PRODUCTION

- New housing production in 1981 totalled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980s. Last year was the worst housing production year since 1946.
- 1982 could finish as the worst post-war production year yet. NAHB's optimistic forecast for this year anticipates annual production of 1.1 million. Housing starts in May were at a seasonally adjusted rate of 1.006 million down [illegible] percent from a year earlier, and down more than [illegible] percent from the peak of over 2 million in 1978.
- May is the 43rd month of recession in housing. The previous record was set during the Eisenhower Administration when a housing recession lasted 27 months.

NEW HOME SALES

- 1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 436,000 new homes were sold, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.
- Since March 1981, annual new home sales rates has been under the 400,000 level for 9 of the past 10 months. In May of this year, the annual sales rate of new homes was [illegible], which is 19 percent below the May 1981 sales rate.
- Actual sales rates in May nationwide were 36,000 new homes--roughly the monthly number of new homes that were sold in the South alone during 1978. In all of the Western States, only 8,000 new homes were actually sold in May. Only 8,000 new homes were sold in the Northeast and North Central states combined.

INTEREST RATES

- Conventional mortgage interest rates still average above 17 percent. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.
- Interest rates normally fall rapidly and decisively during recessions, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15 percent this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depressed levels until mortgage rates drop to the 14 percent range, which by historical standards still represents an extraordinary high cost of home financing.
- By reducing interest rates from 16 percent to 12 percent, 4.6 million additional families could qualify for a $65,000 mortgage. At 12 percent interest rates, more than 22 percent of the nation's families have the $35,000 income needed to qualify for a modest $65,000 mortgage. At 16 percent rates, fewer than 14 percent have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

- Unemployment in the construction trades in June was 19.2 percent or 963,000 unemployed workers, accounting for one out of every ten unemployed members of the work force. Another 200,000 skilled craftsmen could lose their jobs over the next several months.
- An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.
- Bankruptcies are up 51 percent for construction firms and 68 percent for subcontractors.
- Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1 percent increase in unemployment costs the Treasury $25 billion -- $19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

Mr. Chairman, these figures paint a bleak picture for the homebuilding industry. But today, every other business dependent on affordable credit for survival has a similar story. NAHB supports H.R. 6124, introduced by Rep. St Germain (D-RI), Chairman of the Banking Committee, which would extend the Credit Control Act and improve the President's ability to deal with high interest rates and unemployment. S. 2526, a similar bill, has been introduced in the Senate by Senator Cranston (D-CA). As an industry that has been the continued victim of high interest rates, we cannot, in good conscience, reject any standby Presidential authority to deal with this problem.

As the members of this Subcommittee are well aware, we fought long and hard this year for an emergency housing and employment stimulus program to revive our industry and to generate an overall economic recovery. Although both Houses of Congress overwhelmingly agreed with the need for such a program, support was not great enough to override the President's veto. In the aftermath of this legislative battle, we have asked ourselves, what can the Congress and the Administration do to lower interest rates and generate an economic recovery?

One of the principle arguments used by opponents of the emergency housing program was that it was unnecessary, since the overall budget would reduce interest rates. But what happened once the budget passed? Interest rates began an upward climb, and political leaders and economists admitted the budget really wouldn't bring down interest rates.

Furthermore, the Administration is now indicating that the recession may have bottomed out and a recovery could be in the [illegible]. But according to several economists, this recovery won't include the housing industry or others dependent on affordable credit. Although the Administration's mid-year economic forecast calls for a resumption of economic growth, many private economists expect a continued recession. The reason given by the private economists is the continuation of high interest rates. Long term interest rates, on which our industry is dependent, are not expected to fall this year.

What this means for the homebuilders that helped build up this nation's economy, is that there won't be an economic recovery this year. What this means for potential homebuyers is that there will be no light at the end of the tunnel this year. From my discussions with homebuilders and potential homebuyers alike, I find a serious lack of confidence concerning the future of our economy. People are worried whether they will be the next victim of unemployment and whether they can continue to pay their bills. The last thing someone is going to do with concerns such as these is make the largest single purchase of a lifetime, such as a new home. With nearly 10 percent of our work force unemployed, and expectations such as these, a full economic recovery can not and will not occur.

H.R. 6124 retains for the President standby powers to deal promptly and decisively with high interest rates and inflation when other options have failed. In light of current economic conditions and the outlook for interest rates, some sort of a credit policy may be the only option available for reducing interest rates and stimulating economic activity. This legislation also would allow the President acting through the Federal Reserve Board to use this authority to limit non-productive uses of credit.

Those who argue against credit controls as interference in the credit markets ignore or are unconcerned with the difficulties that small businesses and consumers have in competing in the credit markets. The big borrowers, and the federal government is the biggest, continue to pay high interest rates regardless of their cost or impact on their budgets. Corporations are able to tie up billions of dollars in loan commitments, which may never be used or used simply to acquire another corporation. At the same time, the small borrower, who simply cannot afford to pay the "market interest rates," is squeezed out of the market and ultimately out of business. A monetary or credit policy which allows large businesses easy access to credit markets but at the same time chokes off the financing available for interest sensitive small businesses is neither equitable nor efficient. The system concentrates credit on those areas which contribute least to productivity. It is a system which rewards borrowers who are big and punishes those who are small.

H.R. 6124 would "prescribe limitations with respect to credit for non-productive purposes, including corporate takeovers and otherwise ensure the availability of credit for productive and necessary purposes." With this authority, the Administration could still pursue a restrictive monetary policy but could encourage job creation, productivity and the provision of needed housing by redirecting credit away from non-productive uses.

Those who oppose credit controls usually argue that the free market is the appropriate and best mechanism for allocating credit. We disagree with this viewpoint and suggest that in times of recession, the President and the Federal Reserve Board can and

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should make value judgements about what is important and what is less important or of no importance to this society. If owners of casinos, abortion clinics and massage parlors can afford to pay 25 percent for mortgage money, we don't think the American homeowners should be cut out of the market because they can't afford to compete with these and other questionable uses. The whole federal budget is a collection of value judgements about what is important to this society and what is less important or not important at all to this society. There are times when the Government can and should intervene in the private granting of credit to make similar value judgements.

The authority granted the President under the recently expired Credit Control Act of 1969 allows the President, acting through the FED "to regulate any or all extensions of credit in order to prevent or control inflation caused by excessive volumes of credit in the economy." H.R. 6124 would retain those powers but also expand the President's flexibility to deal with high interest rates. The proposed legislation would give the President more authority to reduce high levels of unemployment in any sector of the economy, and to mitigate the impact of recessions.

This legislation correctly reserves these standby powers for the President alone. We believe the President must make the final decision to implement such powers. The legislation also requires the President to work with the Federal Reserve in implementing any credit controls. I would hope this would assure that extensive communication between the President and the Chairman of the FED occured before any controls were activated. These past two years have been a good indication that much more cooperation is needed between our fiscal and monetary policy makers.

In light of the continued levels of high interest rates which are preventing a full economic recovery and the seeming inability of government and business to reduce rates, the standby powers embodied in H.R. 6124 may be the only short term approach to reducing high interest rates. A continued wait for a long term recovery will guarantee further bankruptcies, unemployment and widening budget deficits.

I urge this Subcommittee and the entire Congress to act to extend the Credit Control Act with the added flexibility embodied in H.R. 6124 to allow the President the standby authority to deal promptly with high interest rates. I thank you for the opportunity to present our views on this subject, and would be happy to answer any questions.

Chairman ANNUNZIO. Thank you very much, Dave. Your statement is excellent. I couldn't agree with you more on your last statement.

I have been accused of being a supporter of the military versus social programs, and so forth and so on, but you must remember that when you have people like your son, who is in the armed services, that you are trying to give them the very best to defend and protect themselves and defend this Nation, and I see nothing wrong—I just can't understand what some of these people are thinking about, to have the necessary tools and weapons available so that if our domestic economy is in trouble, we can do something about straightening it out, and this is one of the things that has been lacking. They had it until June 30 of this year but did not see fit to use it. That is no reason that the Congress should allow the Credit Control Act to die completely.

Mr. Schechter, I have one question for you.

Last week, the Penn Square National Bank failed, creating losses of thousands, billions of dollars, of many banks, credit unions, other uninsured depositors who sought the high interest rates offered by Penn Square.

After Penn Square failed, you see—there is a new term now that has come into our vernacular, after we got through with the decontrol bill, the money market funds, and all of a sudden there is $200 billion of funds, and money has been drained out of the S. & L.'s, commercial banks.

I want you to tell us about these money brokers they are talking about, for the record.

What is their function?

Mr. SCHECHTER. Their function seems to have been to obtain funds, induce other banks and credit unions, and so on, to keep Penn Square afloat. They are getting——

Chairman ANNUNZIO. Does Penn Square hire these money brokers because they need all this money, so the money brokers go out to the others?

Mr. SCHECHTER. There is a deeper influence here.

When we allow interest rates to go up high, the institutions themselves have to begin to pay high interest rates to get the funds—this happened in the late 1920's—and therefore, they have to reach. Even if it does not look like a very sound deal, as the bankers put it, they are always looking for a sound loan, but if they are paying 15 percent to get money, of course, they are going to look for something that may even be a little bit shaky as long as it will pay them 17 or 18 percent, and this is what we have happening.

It happened with Drysdale Securities not long ago. It is happening with Penn Square. The Continental Bank of Chicago got hit for about a billion dollars.

All this talk about leaving the financial community to operate in a free market, they are only human beings. They are subject to certain enticements, to make a buck fast, to take a chance.

That is why, if I can go back in history a moment, after the Great Depression, when we had a lot of trouble because of such lending policies, we got the Glass-Steagall Act, which put clamps on them.

After the shake-out following the war, we had about 10 years during the 1950's, practically no bank failures, no mergers needed, so the bankers started coming to you people in Congress and said, look, we are doing a fine job. We don't need all these laws to tell us how to run our business.

Gradually they got more and more freedom. Under the Reagan administration, they have the utmost freedom. Penn Square was not the first failure, so we are back where we were in the late 1920's, early 1930's, with the banking business.

Chairman ANNUNZIO. In other words, when I go to a bank and make a loan or you go or Dave Stahl, they tell you, they say, well, what about your collateral?

Well, we have got to have collateral coming out of our ears before we get money.

Here is a loan portfolio. Penn Square has a loan portfolio, they go to a money broker. They go to this money broker, the money broker just sells the amount of money that Penn Square needs.

They don't care about what is in that portfolio, as far as collateral, whether it is a good loan or a bad loan. They are only interested in the brokerage that they collect?

Mr. SCHECHTER. That sums it up, Mr. Chairman, yes.

Chairman ANNUNZIO. That is the new gimmick since we have gone into this disastrous money situation and high interest rates in this country and even seeking high interest rates has brought about the rise now of money market funds, and now we have another term known as money brokers.

Mr. SCHECHTER. Yes, and if I can add, one of the things that makes it worse is because of the fact that most money is being loaned from one step to another short term, and the bankers now have floating rate loans like the variable-rate mortgage, they think they are safe because they are shifting the risk of an interest rate change to the borrower, but actually they are creating a bigger risk for themselves, because with enough of these things, the whole system begins to fall apart.

Chairman Annunzio. Mr. Prins.

Mr. Prins. I went to school in your section of the country, so I am a little bit familiar with this.

I would like to ask a question and paraphrase it by a little story, and see if maybe this is not true, that we really do have credit allocation in this country.

It is just that the credit allocation is not decided by perhaps the people that we would want to decide it.

The story is this, it is about a farmer who goes into a banker to get a loan, and he goes in and he wants to borrow $4,000, small farmer. The banker says, "What kind of collateral do you have for the loan?"

The farmer says, "Well, I have an old broken-down plow, a one-eyed mule, and I have some old seed back there that I will put up as collateral."

Well, the banker does not want to make the loan, so he comes up with a story to the farmer, he says, "Well, gee, you read the newspapers, Sam, you know that money is scarce. The Federal Reserve is restricting credit, raising interest rates. Money is really, really scarce right now.

"I would love to make you the loan, I really would, Sam, but I can't make the loan because money is scarce."

The farmer thinks for a minute and says, "Well, Mr. Banker, if I had a $4 million farm to put up as collateral for that loan, would you make me the loan?"

The banker smiled and said, "Sam, if you had that kind of collateral, I'd make the loan in a second."

The farmer said, "Well, look, it is not money that is scarce, it is collateral that is scarce."

It is the golden rule right now. We don't have any scarcity of money in this country. We have a scarcity of people getting the money who need the money. If you could pay the price, you could get the money.

Would the whole panel agree with that?

Mr. Schechter. At a price, you can usually get the money, at all times.

Mr. Prins. Thank you, Mr. Chairman.

Chairman Annunzio. Mr. Friedman, the automobile industry, as you and I know, I was part of the panel that went all around the country, it is in disastrous shape.

If interest rates don't come down, in your judgment, how much worse can this situation get?

Mr. Friedman. It is hard to imagine it getting worse than it is. The conditions are absolutely without precedent since the Great Depression in the auto industry. We have a sales level that we haven't seen in 20 or 25 years.

Chairman Annunzio. It can get worse if the interest rates don't come down?

Mr. Friedman. It can't get any better, if they stay so high.

Chairman Annunzio. In the last Depression, we didn't have an automobile industry that amounted to anything, so we have had nothing to go by. You follow me?

Mr. Friedman. Right. If you look back 20 years ago and say the sales now are as low as they were then, that understates how bad things are, because 20 years ago, the country had maybe a third fewer inhabitants.

Chairman Annunzio. That is correct. That is absolutely correct, so we can't judge, don't you see?

Mr. Friedman. Yes.

Chairman Annunzio. I remember the last Depression. My family was a victim of the last Depression. On the block that I lived on, if there were three automobiles, there were three too many. That was a rarity.

As kids, we could skate on the streets and use our bicycles. In those days, we didn't have bicycles. We used to make our own pushmobiles, with the apple box and the 2x4, you see, but the problem, what I am trying to put across, we have no way of comparing this thing.

Today we have developed a great automobile industry in this country, employing some half million workers.

When you look back to 1929 and 1930, you only had 10,000 people employed in the automobile industry, so there is no way that Depression affected the automobile industry. But the automobile industry, once it grew in numbers and in strength and became the greatest producers of automobiles of any country in the world, for us to be flat on our back, and that is economically where we are, we are flat on our back, and I am wondering how much flatter they can flatten us out.

Mr. Friedman. I don't even like to think about that, Mr. Chairman.

Chairman Annunzio. We have to start thinking about these things or you are not going to move these Members of Congress who are living in a sheltered situation.

They are sheltered. They don't know what is going on in the real world.

Mr. Friedman. For 3 years, each year in succession, everyone thought the auto situation couldn't get any worse, only to be proved wrong. The only light at the end of the tunnel seems to be an oncoming freight train.

Chairman Annunzio. But you must admit that every year when you thought it couldn't get worse, it got worse.

Mr. Prins. I wonder if that light at the tunnel might be the rescuers searching for survivors?

Mr. Friedman. Yes, as the latest sales figures show, it is getting worse.

Chairman Annunzio. Mr. Stahl, home construction in 1982, it will set a postwar record low, how much of that decline in your judgment is accounted for by high interest rates and how much by other factors?

I have read in the papers that homebuilding made a slight increase but I would like for you to tell it for the record.

Mr. STAHL. When I was in Chicago, Mr. Chairman, and working on some model cities, antipoverty and human welfare programs, we used to talk about pockets of poverty.

I wish Congressman Paul was here. Houston is a pocket of prosperity.

It has 1 percent of the population of the United States, but 7½ percent of the total housing production in the United States right now. Houston is a beacon, a rare exception.

The rest of the country has been devastated and the greatest single cause is high interest rates.

The difference between 16 percent and 12 percent mortgage rates is that 4.6 million American families are priced out of the housing market.

I think increasingly, however, the length and depth of this recession is hurting the housing industry, and as I said in my testimony, people are having serious doubts about the future.

They are wondering if they will have a job next month or next year, and therefore, they are holding back from making a major commitment to a large capital good, like a house.

The impact of 43 months' decline in our industry is beginning to take it toll and function in concert with high interest rates to make things worse.

Chairman ANNUNZIO. There are elements in this country, and this is my last question, when we talk about homebuilding, they talk about the rise in the building costs. They talk about the labor costs, and those are the other factors that I was getting at.

Actually, the biggest cost contributing to the decline of the homebuilding industry has been interest rates, because when you build a house today, you must consider land costs.

Years ago, nobody ever talked about land costs. Land costs, the building material costs, the labor costs, and everybody is saying, well, labor is the big thing, and I am not here to defend labor, but the truth of it is that I am here to get the facts, that the labor costs have not risen as high as the building material costs and land costs.

Land costs have gone higher in proportion to the labor costs, so we have got to start putting all these elements together.

People have got to start working together, so that they understand, so that just because the makeup artist makes you look good, you know, you can't be sold that kind of a bill of goods. Mr. Stahl is absolutely right when he talks about pockets, just like when we passed that crime insurance bill. I had hearings all over the country, and the fair plan hearings, you know, there were pockets of people in the inner cities of America who could not afford insurance or buy insurance and it would have completely destroyed our cities if we had not gotten that kind of a program.

We should start using those insurance plans, crime insurance plans and some of the other great plans that have worked in this country to help people. This is what we are trying to do with the Credit Control Act.

We are trying to get things moving and trying to do something and it is going to be a long, long fight. I know all of you favor it. I have been in these fights, you know that.

I have the toughest subcommittee on the Hill. Anybody who is a friend of the consumer is a friend of no one, because the consumers praise you one day, and they complain the next day, so it is a tough job.

I want to express my deep appreciation to all of you for bearing with us. We are continuing the hearings tomorrow. We are continuing the hearings on Friday and I am going to try to markup this bill early next week so you can bring that back to the committee that called on me, Mr. Schechter. I hope we will be able to mark it up by Tuesday.

I thank you very much for your contributions.

The subcommittee stands adjourned until tomorrow at 10 o'clock.

[Whereupon, at 1:25 p.m., the subcommittee was adjourned, to reconvene at 10 a.m., Thursday, July 15, 1982.]

[The following questions were submitted to the witnesses by Congressman Paul and appear with the responses of the witnesses:]

Question 1. How do you define a "productive and necessary" use of credit as opposed to a "nonproductive" use of credit? Please be specific.

Response Received From Mr. Schechter

A "productive and necessary" use of credit would (a) add to capability within the economy to increase production or efficiency in production of goods and services traditionally provided through the private market and those traditionally provided through governments, which are needed for the present and future health and welfare of the citizens or defense of the nation, and (b) enable the citizens that are in need of credit to purchase such goods and services, and financially qualified, to receive such credit. A "nonproductive" use is one which would not add to the capability within the economy to increase production or efficiency in production of goods and services needed for the present and future health and welfare of the citizens or defense of the nation.

Response Received From Mr. Friedman

Productive and necessary uses of credit can be defined as those uses which further goals such as economic growth and full employment and which at the same time deserve high social priority. Well-known examples of non-productive use of credit are many corporate takeovers and mergers, and speculative activity. At this juncture, credit to car buyers, home buyers, and for investment in certain hardpressed industries which are key to reindustrialization and economic recovery are clear instances of productive credit use.

Question 2. What guidelines should the Committee consider for these definitions? Please be specific.

Response Received From Mr. Schechter

In addition to the considerations inherent in the definitions themselves, the Committee should consider as guidelines the numbers of people and enterprises that would be affected advantageously or adversely; the degree of deferability of certain economic activities versus the degree of hardships that might be caused by the need to postpone such activities; and the effect of actions that might be taken toward providing relief from, and counteracting prevailing conditions that are economically destabilizing, e.g., recession and/or inflation. A more general guideline would be to take into account the alternative cumulative snowballing effect of the destabilizing conditions if standby credit controls are not adopted temporarily and there is continued reliance exclusively upon monetary policy, which during a tight-money, presumably anti-inflationary period means reliance upon a prolonged prevalence of high interest rates, and the accompanying damage that is caused.

Response Received From Mr. Friedman

Guidelines that should be considered are: employment, social welfare, strengthening the industrial base, regional balance and community stability, and increased distributional equity.

[illegible] What are your priorities for determining who should receive credit [illegible] the Federal Reserve has implemented this legislation?

Response Received From Mr. Schechter

[illegible] the appropriate definitions and guidelines, some selective prefer[illegible] general credit ceiling should be shown for those sectors of the econo[illegible] to high interest rates and have a demonstrated role in [illegible] the economy into and out of recessions. The preference areas would include [illegible] agriculture, autos, small business, and local government public works fi[illegible] On the other hand, credit for activities which do not contribute to produc[illegible] might temporarily be excluded. The latter category would [illegible] corporate merger takeovers, excessive commodity speculation, and such [illegible] gambling complexes and racetracks.

Response Received From Mr. Friedman

[illegible] would clearly single out some industrial sectors for [illegible] credit treatment. For example, more credit at lower interest rates for [illegible] and purchases of other automotive equipment would go a long [illegible] reviving the industry and the economy on a sustained basis. Curtail[illegible] nonproductive uses, coupled with an "easier" monetary policy, [illegible] credit at lower interest rates to the rest of the economy.

[illegible] How would you assess the Federal Reserve's performance during [illegible]

Response Received From Mr. Schechter

[illegible] Federal Reserve policies, rather than performance, are what the AFL-CIO [illegible] over the past few years. More specifically, there has been too [illegible] tight money and high interest rates to "wring [illegible] at a terrible price that workers, businesses, and local [illegible]

Response Received From Mr. Friedman

[illegible] the Federal Reserve has focused on combatting infla[illegible] policy which, as the UAW warned all along [illegible]

[illegible] of the Federal Reserve's performance is less than satisfactory in [illegible] should the Congress give that same Federal Reserve the power to [illegible] credit in this country?

Response Received From Mr. Schechter

[illegible] of the Federal Reserve in the implementation of credit controls [illegible] that needs to be triggered by the President, was help[illegible] credit, although some selective preference was in[illegible] Federal Reserve to banks. There was some unintended [illegible] credit which can be attributed to inexperience in [illegible] authority under the Credit Control Act.

Response Received From Mr. Friedman

[illegible] would be established by H.R. 6121, the [illegible] for the Federal Reserve in con[illegible] should be coupled with [illegible] the Federal Reserve Board more account[illegible] to the executive and legislative [illegible]

[illegible] to bring down the unem[illegible] percentage point[illegible] with such [illegible]

[illegible] From Mr. Schechter

[illegible] between December [illegible] March 15, [illegible] percent [illegible] 5 per[illegible] centage point from the low of 5.6 percent in July 1979. During those seven intervening months, both short-term and long-term interest rates had been rising sharply, while the seasonally adjusted annual rate of housing starts, industrial production, and the manufacturing capacity utilization rate were trending downward.

The recession was already in the making and gathering momentum before credit controls were placed in effect. A drop in unemployment is the result of developments of preceding months. That fact is most vividly illustrated by the rate of new housing unit starts which declined from a peak seasonally adjusted annual rate of 1,874,000 in September 1979 to 1,041,000 in March 1980, a 43 percent decline. Before new units are started, builders must have a mortgage commitment for a mortgage that will be closed and delivered to the lender six months to a year later after the house is completed and sold. Therefore, the decline in starts lags a month or two behind the rise in interest rates. The decline in construction employment lags a few months behind the decline in starts as workers are still employed finishing residential structures that were started six to twelve months earlier. These effects, shown on the attached table, indicate how the unemployment effects experienced during the credit control period were related to prior rises in interest rates that reduced economic activity. They also show how a decline in interest rates, resulting from the March-July credit controls, led to a pick up in housing starts and construction activity that cut the 1980 recession short and led to a prosperous second half.

Month	National average commitment rate [1] on conventional home loan with 80 percent loan to price ratio (percent)	Seasonally adjusted annual rate of new private housing unit starts [2] (thousands)	Construction unemployment [3]	
			Percent rate	Number of workers (thousands)
[illegible]	11.09	1,874	9.2	583
[illegible]	11.54	1,710	10.0	541
[illegible]	12.93	1,522	10.5	572
[illegible]	12.87	1,548	11.2	614
[illegible]	12.76	1,419	11.7	630
[illegible]	12.81	1,330	11.3	601
[illegible]	14.26	1,041	13.1	697
[illegible]	16.16	1,030	14.6	759
[illegible]	15.28	906	16.4	869
[illegible]	[illegible]	1,223	15.7	850
[illegible]	[illegible]	1,265	15.8	812
[illegible]	12.13	1,429	16.7	857
[illegible]	12.88	1,541	15.8	814
[illegible]	13.44	1,557	14.2	744
[illegible]	13.88	1,561	14.5	767
[illegible]	[illegible]	1,548	13.8	711

RESPONSE RECEIVED FROM MR. FRIEDMAN

Use of credit controls in the present situation could reduce unemployment by channeling funds at reasonable rates to sectors, such as auto, construction, and agriculture, which have been clobbered by high interest rates and recession. However, use of credit controls does not preclude the need for other antirecessionary measures such as public employment programs and public investment, and longer range stabilization policies.

Question 6. H.R. 6124 authorizes the President to invoke the Credit Control Act at virtually any time. That Act grants the Federal Reserve the authority to "prescribe appropriate requirements . . . as the form, contents, or substantive provisions of contracts . . ." I read this to mean that the Federal Reserve could suspend all existing contracts or require them to be renegotiated to meet the contents and provisions the Federal Reserve desires. How does your association feel about granting this kind of authority to the Federal Reserve?

6. Retail sales fell at a 15% annual rate from January to May.

7. Farm income fell. In the first half of 1980, there was a 11.5% rate of *increase*, and in the second half a 20% rate of *decrease*.

Standby Authority Leads to Uncertainty

If the President were given standby authority to impose credit controls, as provided by H.R. 6124, substantial uncertainty in the economy would result. Moreover, in periods when the imposition of such control appeared likely, investors would certainly take precautionary measures. In late 1979 and early 1980, interest rates were falling as economic activity was slackening; the prime rate fell from 15.6% in November 1979 to 15.2% in January 1980. However, rumors of credit controls, even though denied by the Administration, were a major factor causing an increase in the prime rate to 18.3% in March 1980. Short term business credit also grew by 32% in a three month period, the highest rate ever recorded for this type of borrowing. This general increase in borrowing was caused in large measure by the mere rumor of controls. The threat of controls could raise interest rates even if the standby authority was never exercised.

Standby authority adds to uncertainty in other ways. Firms will make fewer long term commitments as the risks of unpredictable government actions become higher. Investors will also increase their investment in foreign countries if they fear domestic controls.

The greater the chance of credit controls being imposed, the more pronounced these effects will be. The existence of statutory authority for the President to arbitrarily impose controls would increase this uncertainty. If no such authority exists, then investors would know that controls could be imposed only after a lengthy legislative process, and would be less worried about the possibility.

Implementation

In today's economic environment, implementation of credit controls would prove extremely burdensome. In recent years, high interest rates have made the development of many alternative financial services worthwhile. For example, there is now intense competition between banks, savings and loan associations, brokerage houses, and checkable money market funds. Controls on any one segment of this market would simply force savers and investors to turn to another. Moreover, the rate of innovation in these markets is substantial, so that, even if all could be controlled, we would expect new institutions to be developed quickly which would not be subject to controls. Checkable money market funds as a way around the regulation of maximum interest rates paid by banks provides an instructive example. Thus, any attempt at control of credit would need to be all-encompassing to be effective. Moreover, the complexity of financial instruments now available means that any controls would require a large staff for monitoring, and would thus add further layers of bureaucracy to governmental regulation of financial markets.

Summary

Credit controls are an extremely bad policy. They lead to substantial losses in incomes and employment; create uncertainty in the economy; and are probably unworkable in today's economy. Moreover, recent experience with such controls indicates that these predictions are not merely theoretical, but are in fact indicative of what would occur and has occurred. Therefore, I urge that H.R. 6124 not be enacted. The allocation of credit should be left to market forces, and inflation and interest rates should be reduced by sound monetary and fiscal policies.

NFIB National Federation of
Independent Business

STATEMENT OF

JAMES D. "MIKE" MCKEVITT

DIRECTOR OF FEDERAL LEGISLATION

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

SUBMITTED TO:	Consumer Affairs Subcommittee of the Banking, Finance and Urban Affairs Committee
SUBJECT:	Credit Allocation and Controls
DATE:	July 15, 1982

The National Federation of Independent Business (NFIB), on behalf of its more than 500,000 small and independent business members, appreciates this opportunity to express its views on credit controls and the extention of authority to institute a credit allocation program. The organization's members have expressed opposition to any credit allocation scheme including one in which small business holds a priority. NFIB, therefore, opposes legislation providing authority to institute credit controls or allocation.

Small Business Credit Problems

Small business currently has a serious credit problem. That problem is not one of credit availability; it is a problem of credit price. While the price problem eventually creates an availability problem for some as a practical matter, credit is available if the small owner is willing to pay for it (see Table 1 for recent costs).

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TABLE 1

Interest Rates on Short-Term
Loans to Small Businesses

	Average Interest Rate (Percent) Year and Quarter					
	1980 IV	1981 I	1981 II	1981 III	1981 IV	1982 I
Sm. Business Rate	18.0	17.7	19.0	19.3	17.9	17.8
Prime Rate at Quarter's End	20.2	17.2	20.4	18.5	15.8	16.5

SOURCE: NFIB Quarterly Economic Report for Small Business

Three types of small businesses are impacted particularly severely by high interest rates: 1) firms dependent on consumer borrowing for sales, e.g. contractors, real estate businesses, etc., 2) firms carrying large inventories which are caught by recession and the negative effects of reduced inflation, and need operating capital, e.g. many wholesalers and retailers, and 3) firms in the process of expansion. Since these classes constitute an enormous share of the small business population, the credit price problem obviously has a substantial impact. It is little wonder "Interest Rates-Financing" replaced "Inflation" as small business's single most important problem in July, 1981, and has held that dubious honor every quarter since.

The problem created for small business by high interest rates is well-known. The question is "how and/or what public policy(s) will reduce them?" Will credit allocation help?

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Current Credit Allocation Programs

It must be understood at the outset that the United States already has a program of credit allocation. The program operates in one simple and one complicated way. The simple way is that the federal government's credit needs are insensitive to price. Interest rates make no difference to it. The federal government just establishes and fulfills its credit "needs" regardless of cost. Since all other borrowers become price sensitive at some point, the federal government allocates to itself the first priority. Other borrowers must compete for any credit that remains as a lower priority user.

The second method of credit allocation is less direct. It involves provision of loan guarantees which in turn reduces the risk premium lenders charge. Presumably, the guaranteed borrower is marginal at best or else the guarantee wouldn't have been required to provide a guarantee in the first place. A guarantee effectively shoves the marginal borrower to the top and an otherwise acceptable borrower is pushed off the list (through the market price mechanism).

The amount of credit the federal government allocates in these two ways is enormous. Given reasonably estimated federal deficits of just less than $100 billion in f.y. 1982 and well over $100 billion in f.y. 1983, it is estimated federal borrowing will devour over 55% of total funds raised (borrowed money) next fiscal year. Looked at from another perspective, the federal government in f.y. 1983 will absorb more than 100% of all net new savings. Then there are the loan guarantees to be added. With the Fed holding down increases in the money supply and the savings rate not changed appreciably on the supply side, and the government hogging the demand side, it is only surprising that anyone is surprised by current interest rates.

Despite the pervasiveness of current credit allocation and the undeniable negative economic consequences, the argument runs that what little credit is left must be carefully allocated on high priority items. The most recent experience is not encouraging.

The Fed with the Administration's acquiescence imposed credit controls in early 1980. It was believed at the time that consumers were borrowing too heavily. Reducing consumer borrowing was desirable as a means of reducing interest rates, ran the rationale, and with lower interest rates healthy economic growth would ensue.

The program worked! Consumers stopped borrowing and interest rates plunged. Unfortunately, the GNP also plunged -- at an annualized 9% rate during the second quarter -- and when recovery began interest rates rose once more.

Conclusion

NIFB opposes credit controls and/or allocation. We see too much government as the cause of the interest rate problem, not more government as the solution to it. Legal authority to impose such controls, even if it lies dormant, serves no useful purpose.

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NATIONAL ASSOCIATION OF REALTORS

Julio S. Laguarta, President
Harley W. Snyder, President-elect
Donald H. Treadwell, First Vice President
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777 14th Street, N.W., Washington, D.C. 20005
Telephone 202 383 1000

July 16, 1982

The Honorable Fernand J. St Germain
House of Representatives
Washington, D. C. 20515

Dear Mr. St Germain:

We commend the Committee for its role in allowing the Credit Control Act of 1969 to expire June 30, 1982. We recommend that it not be reinstated.

We are unimpressed by the general usefulness of economic controls such as those imposed under both a Republican Administration (Nixon) and a Democratic Administration (Carter).

We are fearful, in particular, that credit controls, if used, would work to the disadvantage of American home owners. The current Administration and the Congress have recently and repeatedly demonstrated lack of support for home ownership. Instead, on actions related to home ownership, the focus has been almost exclusively on the needs of industry.

Sincerely,

Julio S. Laguarta
President

Harley W. Snyder
President-Elect

Jack Carlson

Jack Carlson
Executive Vice President

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STATEMENT ON H.R. 6124
A BILL TO
BROADEN AND EXTEND THE CREDIT CONTROL ACT

My name is Alfred P. Johnson. I am Vice President and Chief Economist of the Investment Company Institute. The Institute is the national association of the American mutual fund industry. Its membership includes about 689 open-end investment companies, or mutual funds, their investment advisors and principal underwriters. Its mutual fund members have assets of about $247 billion and have approximately 16.5 million shareholders.

H.R. 6124 is a bill to extend and broaden the Credit Control Act which expired June 30. The stated objectives of the bill are to reduce interest rates, control inflation, insure the availability of credit for production purposes, and promote economic recovery. These are unexceptionable goals shared by all. Unfortunately, the passage of the bill would impede, rather than promote them. It should, therefore, be rejected.

The primary problem of the bill is that, if passed, it would provide sweeping authority to impose direct controls. The bill, in essence, would be an accident waiting to happen. The form the meddling in the marketplace might take cannot be seen through the veil of vague language included in the bill. Consequently, even some of its current supporters could be stunned by the ways the powers might eventually be used.

In any event, credit controls in virtually any form are an exceedingly inefficient way to deal with inflation, high interest rates, or economic growth and stability. They can, in certain circumstances, temporarily limit increases in interest rates or prices, but controls never have a lasting effect other than to disrupt the allocation of resources and disorganize the market system. Direct controls not only don't work, but in peacetime they create formidable problems of enforcement and impose undue cost burdens on the businesses subject to regulation.

The risks associated with selective controls should not be taken, since there is already in place a general regulatory system which includes: open market operations, the discount mechanism, legal reserve requirements, federal fiscal policy and debt management. What is needed is greater wisdom, courage and skill in using these general controls, rather than an expansion of direct regulation.

The Federal Reserve, for example, can control credit expansion by regulating monetary expansion. Moreover, money growth is the factor that ultimately has the stronger influence on prices and economic activity. If the Fed manages the monetary targets effectively, direct controls are redundant. If they do not, they are futile. The central bank's task is made easier or more difficult depending upon how fiscal policy is combined with monetary policy.. At the moment, the fiscal-monetary policy mix is considerably less than optimum. This partly explains why interest rates are higher than is good for the economy.

It should be stressed that the economic and financial systems are not presently plagued by an excessive rate of credit expansion. In 1982, the total volume of net funds raised is expected to be about $477 billion.* This dollar increase represents a growth in total outstanding liabilities of about 7.2 percent, a rate similar to 1981. These growth rates are substantially less than the rates that prevailed during the years 1973-79. In that period, the total volume of funds raised expanded by an average rate of 8.9 percent, including increases of 11.1 percent and 9.9 percent in 1978 and 1979, respectively.

The slackening in demand for credit in recent years has largely been centered in the private sector, particularly among households. Demand for credit to finance cars and homes, for example, is way off because the prices of these "big ticket" items have increased sharply over the years. In addition, high interest rates and more stringent credit terms have increased monthly debt payments. This development has severely limited the number of people who can qualify for credit. Moreover, some of the potential borrowers who meet the standards of lending institutions are reluctant to commit themselves to large installment payments for long periods when the economy is moving in a sluggish uncertain fashion.

One of the participants in the credit market that *is* absorbing huge sums of money at an accelerating rate is the U. S. Government. It is expected to raise $132.5 billion of new funds in calendar year 1982 and $140.0 billion (at an annual rate) during the first half of 1983. These estimates are much higher than average borrowing of about $83 billion during calendar years 1980-81.

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*Estimates of funds raised are from the "Weekly Credit Bulletin", July 2, 1982, Merrill Lynch, Pierce, Fenner and Smith, Inc.

Moreover, all of these figures are inflated further, if the borrowing of Government agencies is included.

When these dollar figures are converted to market shares, we find that the Government is expected to account for almost 30 percent of total funds raised in the current period. By contrast, Government borrowing represented only about 8.0 percent of the total in 1979 and about 18.0 percent during calendar years 1980 and 1981. It is clear that the Government, because of its need to finance huge budget deficits, is presently absorbing funds that might otherwise be available for use by consumers and businesses in the private sector.

It should be emphasized that current trends in credit demands, inflation, and interest rates, do not indicate the need for any such drastic action as the revival of the Credit Control Act. As noted earlier, credit demands -- with the exception of the U. S. Government -- are moderate. Inflation has receded and interest rates are down significantly from their peak.

Consumer prices, for example, rose 2.0 percent during the first five months of this year and 5.8 percent for the most recent twelve months. These figures compare with an annual increase in prices of 12.4 percent in 1980 and 13.3 percent in 1979. Similar progress has been made toward lowering interest rates. The commercial paper rate, which was as high as 20.0 percent at the end of 1980, is now about 14.5 percent.

While the current level of interest rates is higher than is desirable at this stage of the economic cycle, general monetary measures have moved us in the right direction. Reinstatement of the Credit Control Act at this juncture would raise questions in the minds of many participants in the financial market. Basically, they would wonder about the strength of the Government's commitment to resolve our economic problems with a minimum of intervention in the marketplace. Uncertainties of this sort do not help to bring down interest rates.

Up to this point, the case against reinstating the Credit Control Act has been made primarily on conceptual, economic grounds. There is, however, actual experience under the Act. An impartial legislative review of the usefulness of direct credit restraints should, therefore, consider how well the public fared when actions based on the Act were imposed on segments of the marketplace in the period March-July 1980. There is widespread agreement that this one short experience can be described in a word: Disastrous.

Credit restraint measures were instituted in 1980 at a time when credit demands were slowing down. The main targets were consumer revolving credit -- largely charge cards and other small denomination retail credit -- and short-term business credit. Credit restraining actions tended to limit consumer and business spending and accentuated the economic declines already in progress.

All of these negatives were imposed on the economy without any obvious benefits to the farmers, small businessmen, housing, and other groups that were supposed to be helped by the credit restraint programs. Recognizing this, the Government decided to cut its losses and quietly walk away from the program after a brief but bitter trial.

The perverse results that may flow from reinstating an Act with powers as sweeping as the Credit Control Act is also illustrated by the March-July 1980 experience. In that period, money market mutual funds were caught up in the web of regulation. Specifically, they were required to maintain a "non-interest bearing special deposit" with the Federal Reserve equal to 15 percent of the amount by which the investment assets of the fund exceeded its investment assets on March 14, 1980.

The alleged reasons for the 15 percent tax on the shareholders of money market funds were that funds in some mysterious way contributed to inflation and channelled savings into areas that were less productive than competing alternatives. No evidence in support of these allegations was ever presented. Moreover, the contributions funds make to credit and savings markets were apparently ignored. Funds, after all, lend to banks, businessmen, and the Government, as well as others. The notion that money market funds contribute to inflation, when they encourage saving, is particularly absurd. And the failure to recognize the help funds provide to small savers and small businessmen is also disappointing. But many things are likely to be swept away when broad powers such as those included in the Credit Control Act are implemented. The restrictions on money market funds in 1980 accomplished nothing, but they imposed cost burdens on both shareholders and fund organizations.

In summary, the Credit Control Act should not be reinstated. It is unnecessary and, if used, it is likely to be both arbitrary and ineffective. In this instance no action will produce positive benefits for the U. S. economic and financial systems and the public in general.

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TO EXTEND THE CREDIT CONTROL ACT

FRIDAY, JULY 16, 1982

House of Representatives,
Subcommittee on Consumer Affairs and Coinage,
Committee on Banking, Finance and Urban Affairs,
Washington, D.C.

The subcommittee met, pursuant to call, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Frank Annunzio (chairman of the subcommittee) presiding.

Present: Representative Annunzio.

Also present: Representative George Hansen of Idaho.

Chairman **Annunzio**. The meeting of the subcommittee will come to order.

Yesterday afternoon, the legislative schedule was announced for the following week, and there is no legislative schedule on the floor of the House, and, consequently, many of the Members have returned home. But, when you have the honor of chairing a subcommittee like I do, you do not have that luxury of returning back home, so I wanted to make that explanation, and have the witnesses understand as to why other Members are not present this morning.

This morning, I will ask the following people to take their seats at the table, and we will continue as though we have a full membership.

The record will have your complete testimony, because we will be marking up this bill next week.

I know that the people that are on the panel this morning, the witnesses, have a point of view that is similar to many of the members of this panel on the minority side, and it would have been interesting to have some of the minority listen to your testimony, because I know that you have a contribution, a great contribution, a constructive contribution, to offer to their point of view.

Our first panelist this morning is Prof. David I. Meiselman, Virginia Polytechnic Institute, Department of Economics, member of the Committee on Banking, Monetary and Fiscal Affairs of the U.S. Chamber of Commerce.

Welcome, Professor.

Mr. Robert A. Mooney, manager of corporate economics, J. C. Penney Co., Inc., New York, representing the National Retail Merchants Association and the American Retail Federation.

Mr. Robert J. Genetski, vice president and economist, Harris Trust & Savings Bank, Chicago, my own city of Chicago, representing the American Bankers Association; Dr. Thomas A. Durkin, director of research and education, National Consumer Finance Association; and Mr. Drew V. Tidwell, general counsel and secretary, Consumer Bankers Association, accompanied by Nancy Z. Spillman, director, Center for Economic Education and professor of economics at L.A. Trade Technical College.

I welcome each and every one of you to the panel this morning.

I know that you all have prepared statements, so, without objection, your entire statements will be made part of the record.

You can all proceed in your own manner. You are not limited to any time, so if you are brief, fine, and if you are not brief, I have nothing else to do today but sit and listen to you.

Professor Meiselman?

STATEMENT OF DAVID I. MEISELMAN, PROFESSOR OF ECONOMICS AT VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY, AND MEMBER, BANKING, MONETARY AND FISCAL AFFAIRS COMMITTEE OF THE U.S. CHAMBER OF COMMERCE

Mr. MEISELMAN. Mr. Chairman, thank you very much. I have a brief statement, and I would like to read it for the record.

My name is David Meiselman. I am professor of economics at Virginia Polytechnic Institute.

Chairman ANNUNZIO. You say you have a brief statement?

Mr. MEISELMAN. I have submitted a statement.

Chairman ANNUNZIO. I want your complete statement for the record.

Mr. MEISELMAN. I have a complete statement.

I will make reference to that in my comments.

I am professor of economics at Virginia Polytechnic Institute and State University and director of its graduate economics program in northern Virginia.

I am also a member of the Banking, Monetary and Fiscal Affairs Committee of the U.S. Chamber of Commerce.

I am here today for the U.S. Chamber of Commerce to oppose H.R. 6124. I appreciate the opportunity to present my views.

H.R. 6124, as you know, seeks to extend the Credit Control Act by giving the President the power to authorize the Board of Governors of the Federal Reserve "to regulate and control any and all extensions of credit" and, I quote again, "to prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise insure the availability of credit for productive and necessary purposes."

I have devoted most of my professional career of some 30 years to the study of money, credit and financial markets. Part of that study has been directed to economic history and to the history of economic thought, especially relating to money, finance, and interest rates.

I have also followed ongoing economic and financial developments and related public policy decisions. From time to time, I have attempted to make my own contributions to the analysis of economic and business developments and public policy issues.

From that perspective, I must say that H.R. 6124 has a certain deja vu quality about it. We have all been here before, not once, but over and over and over again.

As recently as the 1980 credit controls, in episode after episode in our own country and in others, attempts by governments to allocate credit have created more difficulties than they have alleviated and have added to problems rather than solved them.

Have we learned nothing from history? Or do the words cut in stone at the entrance to the National Archives—"What's Past is Prologue"—really mean we are doomed to repeat the errors of the past?

To avoid repeating past mistakes, I would urge this committee to review previous attempts to impose credit controls as well as efforts to distinguish so-called nonproductive and productive uses of credit. Some months after the 1980 credit controls were lifted, the Economic Policy Division of the U.S. Chamber of Commerce prepared a study to review the March 14, 1980, implementation of the Credit Control Act of 1969.

That study is an appendix to my prepared remarks, and I ask permission to include the study in the record.

The 1980 controls were in place for only 3 months, and the serious damage they caused was evident to all. When the controls were lifted in July 1980, there was essentially no support for retaining them.

Regarding the controls, the chamber study notes:

> Their immediate effect on financial markets was one of shock, confusion and turmoil; interest rates soared, bond and stock prices collapsed and credit was unavailable to many borrowers at any price. This was quickly followed by acute monthly declines in measures of real economic activity such as retail sales, employment, housing construction and auto sales

Once controls were lifted, economic revival started almost immediately.

To achieve lower interest rates in general requires a reversal of some or all of the factors that have made the complex of interest rates high in the first place. Standing on the top of Capitol Hill and shouting at financial markets or ordering interest rates to fall will no more succeed than did King Canute, who tried to bark orders at the ocean tides—unless, of course, Congress and the Federal Reserve, which is the creature of Congress, change the policies that have caused the high interest rates.

I shall return to this theme at the end of my remarks.

There are many different varieties of interest rates. Interest rates may be classified by maturity, default, risk characteristics, by borrower, and so forth. To be sure, public policy measures can be taken that lower this or that individual interest rate. For example, by explicit subsidy, or by implicit subsidy, as in the case of tax-exempt municipals and Government guarantees of private debts.

These subsidies initially either lower the after-tax cost to borrowers or increase after-tax costs to lenders, thereby inducing lenders to shift funds to these subsidized uses from other uses, and I emphasize the shift from other uses. Unless the total supply of credit is somehow increased more credit to subsidized uses means less credit to unsubsidized uses.

The lower rates and lower borrowing costs for subsidized loans are inevitably linked to higher rates and higher borrowing costs for unsubsidized loans. However, there is more than an equal swap of some higher rates for some lower rates, because the supply of credit is used less efficiently; some credit is put to less efficient use.

The result is that even though some highly visible interest rates may fall, depending on the subsidies or controls, the average effective cost of funds increases.

I may add that the vast number of Federal subsidies for elective forms of borrowing, itself leads to wasteful use of credit and is one of the main reasons why interest rates are now so high, especially for nonsubsidized borrowers.

By the same token, given the supply of credit, restrictions on—or additional taxes on—the use of borrowed funds for specific uses effectively increases costs for some uses and denies funds to other uses. Credit will tend to flow away from these control uses to all creditors. Perhaps it will lower rates in other areas.

The possibility of changing specific interest rates is, of course, a great incentive for some borrowers to use political means to alter market alternatives, in effect, to use government to slice up the credit pie in their favor at less than market rates.

Again, the inevitable result is higher rates for the remaining reduced supply. Other borrowers are effectively stuck with higher costs, and lenders do not necessarily receive higher returns. Widening the range of controls and interest subsidies only makes the rigged system even more burdensome, wasteful, and costly.

It should not be necessary to repeat that private sector borrowers do not incur debt and pay the interest on the debt for frivolous reasons. Individuals balance costs and benefits in their spending decisions. By the same token, private sector individuals and businesses do not incur interest costs unless the added benefits justify the added costs, but what is effectively an ongoing auction in the market system is an integral part of the free market mechanism that channels resources, including credit, to their most efficient uses. This is why directing resources from high productivity uses to low productivity uses lowers overall productivity and output.

It may be tempting to label somebody else's uses of credit as nonproductive, but there seems little or no objective justification for the label "nonproductive" if private individuals and businesses use or pledge their own assets.

To be sure, many individuals make mistakes in the sense that they borrow in advance in anticipation of a profitable outcome, which is to say, where returns exceed borrowing costs only to discover later that returns fall short of borrowing costs. Such mistakes are inevitable in a free market profit-and-loss system.

However, the market system assures that such mistakes are self-correcting, self-limiting, and are not systematic. In addition, those who make the mistakes bear the costs.

Unfortunately, there are no such incentives or constraints, or controls, or regulation, or Government subsidies. Indeed, the tradition of Government is to keep sending more and more good money after bad, and those who make the mistakes send the bills to the taxpayers.

If nonproductive means that returns do not justify costs, why, then, is regulation or controls required to achieve what is in the best interest to private sector transactions? Surely private borrowers and lenders know their own circumstances better than distant Government officials. Certainly private borrowers and lenders have stronger incentives to avoid wasting or endangering their own resources compared to a Government nanny who may have other axes to grind or serve other interests or objectives, including their own.

For hundreds of years, there have been recurring efforts to label some private uses of credit as nonproductive, even when people use their own assets or pay borrowing costs, themselves.

Typically, as in H.R. 6124, nonproductive is not defined. It is not demonstrated, so it usually comes down to a use of credit that is not understood or not popular or perhaps credit that can be seized, expropriated or diverted by the government as credit allocation becomes a political rather than a market process.

In the case of H.R. 6124, corporate takeovers are the only example given of nonproductive credit.

Now, labeling something does not necessarily make it so, including calling corporate mergers and acquisitions nonproductive.

Mergers and acquisitions are important guarantors of management efficiency. When the management of a corporation is not doing its job properly, one way to replace the management is for outsiders to acquire the corporation and enhance management. Enhanced profits and capital gains are incentives for the acquiring corporation.

in principle, borrowing funds for an acquisition of this kind is no different than buying a productivity enhancing machine on credit.

To be sure, not all machine purchases turn out well, and neither do all corporate mergers, either.

Many corporations are launched and their products and markets are developed with a view toward eventually selling the corporation. This is true for small innovating business firms, where the bulk of new ideas and new jobs are created, as well as for closely held or family corporations, owners of which wish to retire to, diversify or to change activities.

Other corporate acquisitions and mergers reflect attempts to make more efficient use of plant and know-how, gain access to better markets or better management, achieve economies of scale, and the like.

Also, from time to time, many corporations wish to restructure their activities, shedding some products and markets in order to focus on others. Limiting the merger and acquisition abilities of these corporations will mean lower prices for their stocks, less innovation and invention, and fewer jobs. Restricting mergers and acquisitions by credit controls will also restrict entry and retard productivity enhancing technology production, technology transfer and market flexibility.

This resulting impaired productivity and loss of jobs is the inevitable consequence of restricting mergers and acquisitions. It would also be an excellent but regrettable textbook example of a clear nonproductive act. It is also important to recognize that when a corporation is acquired for cash, even assuming that all the cash is borrowed, that this is not the end of the credit line. The sellers who formerly owned corporate stock do initially hold stock. In that sense, they are no different than individuals who sell any stocks or bonds; in fact, any product, even 10 shares of IBM or AT&T.

After all, money is the medium of exchange. However, sellers of stock typically hold the received cash only temporarily. Instead, the cash is used mainly to buy other securities or is otherwise invested. When the funds are invested, the funds initially borrowed by the acquiring corporation are made available to other borrowers or other segments of the market.

Money and credit are fungible. Corporate mergers are certainly not the only reason for the high and volatile interest rates. It borders on scapegoating to blame high interest rates on merger activities or to suggest that impeding mergers and acquisitions will somehow lower interest rates for potential home buyers, for new business, for farmers or for others.

The lives and property of each one of us are closely tied to credit and credit markets. This is why our liberties as well are also linked to financial markets. This is why giving the Federal Reserve Board or any other Government agency control over the quantity and price of credit, is more than a danger to our productivity; it would be a serious threat to our personal freedoms.

The only sure way to reduce interest rates is to reverse the public policies that have caused them in the first place.

Perhaps the text for the day should be from that wise philosopher and economist, Pogo, who noted, "We have met the enemy and he is us."

Through the years, Congress has enacted a tax code that is severely biased against saving and investments. This is one of the reasons Americans save and invest such a small fraction of their incomes. At the same time that the Tax Code penalizes saving and subsidizes consumption, higher and higher levels of Government spending also subsidizes, consumes and diverts resources from saving and capital formation and other productive uses.

Running huge deficits to finance such bloated budgets add their own push toward higher interest rates. In effect, the tax and spending policies since at least 1965 have greatly increased credit demands by subsidizing or otherwise encouraging the private sector to go into debt while directly using vast amounts of credit directly to finance budget deficits, all the while restricting the supply of credit by penalizing the savers who create the supply of credit.

The main reason for the high interest rates, of course, is the rising tide of inflation. To be sure, there are waves of faster and slower rates of inflation, but the overall trend of inflation has been sharply higher for close to 20 years.

The main reason for inflation is excessive creation of money by the Federal Reserve, which is accountable to Congress. The only way inflation can be restrained or eliminated is to slow the increase in money, because fast money growth causes inflation, and, in turn, inflation increases interest rates, and easy money leads to tight credit. Similarly, because slowing money growth results in lower inflation, and lower inflation eventually causes interest rates to decline, tight money leads to easy credit.

These effects are strengthened by bracket creep, the impact of inflation on tax rates. With more inflation, taxpayers are pushed into higher brackets. This means the savers pay a larger and larger fraction of their interest receipts in taxes, lowering their after-tax returns. Thus, bracket creep is an independent source of enlarging the tax bias against saving and thereby contributes to higher and higher interest rates.

To sum up, many of our citizens do have serious problems with high interest rates. Ignoring fundamental causes of the high interest rates and adding a new set of controls will not solve our problems or theirs, but merely add to them. Instead, I would strongly urge the Congress to undo the policies that have created the high interest rate problem in the first place, by requiring slow and steady money growth, by reducing expenditures, especially those that subsidize consumption, and by prudent tax reduction that lessens the tax bias against saving and investment.

Finally, I note that during much of the 18th century, the age of mercantilism, it was widely believed that only farming was productive, and with the aid of hindsight and the wisdom of Adam Smith, we all realize how badly mercantilism performed and how it stood in the way of the improvement of the lives of ordinary people at that time.

Yet some of us propose a reactionary return to a 20th Century mercantilism.

The new mercantilism will serve us no better than the old, and I urge you to reject it.

Thank you very much.

[Mr. Meiselman's prepared statement and a paper, "A Review of the March 14, 1980, Implementation of the Credit Control Act of 1969," follow:]

STATEMENT
on the
EXTENSION OF THE CREDIT CONTROL ACT
before the
SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE
of the
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
DR. DAVID MEISELMAN*
July 16, 1982

My name is David Meisleman. I am Professor of Economics at Virginia Polytechnic Institute and State University and Director of its Graduate Economics Program in Northern Virginia. I am also a member of the Banking, Monetary and Fiscal Affairs Committee of the U.S. Chamber of Commerce. I am here today for the Chamber to oppose H.R. 6124.

H.R. 6124 seeks to extend the Credit Control Act by giving the President the power to authorize the Board of Governors of the Federal Reserve "to regulate and control any and all extensions of credit" and "to prescribe limitations with respect to credit for nonproductive purposes, including corporate takeovers, and otherwise ensure the availability of credit for productive and necessary purposes."

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*Professor of Economics at Virginia Polytechnic Institute and State University and Director of its Graduate Economics Program in Northern Virginia

I have devoted most of my professional career of some thirty years to the study of money, credit and financial markets. Part of that study has been directed to economic history and to the history of economic thought, especially relating to money, finance and interest rates. I have also followed ongoing economic and financial developments and related public policy discussions. From time to time, I have attempted to make my own contributions to the analysis of economic and business developments and public policy issues.

From that prospective, I must say that H.R. 6124 has a certain dèja vu quality about it. We have all been here before, not once, but over and over and over again. As recently as the 1980 credit controls, in episode after episode in our own country and in others, attempts by governments to allocate credit have created more difficulties than they have alleviated and have added to problems rather than solved them. Have we learned nothing from history? Or do the words cut in stone at the entrance to the National Archives, "What's Past is Prologue" really mean we are doomed to repeat the errors of the past?

To avoid repeating past mistakes I would urge this Committee to review previous attempts to impose credit controls as well as efforts to distinguish so called non-productive and productive uses of credit. Some months after the 1980 credit controls were lifted, the Economic Policy Division of the Chamber of Commerce of the United States prepared a study to review the March 14, 1980 implementation of the Credit Control Act of 1969. That study is an apprendix to my prepared remarks, and I ask permission to include the study in the record. The 1980 Controls were in place for only about 3 months, and the serious damage they caused was evident to all. When the controls were lifted in July, 1980 there was essentially no support for retaining them. Regarding the controls, the Chamber study notes "Their immediate effect on financial markets was one of shock, confusion and turmoil; interest rates soared, bond and stock prices collapsed and credit was unavailable to many borrowers at any price. This was quickly followed by acute monthly declines in measures of real economic activity such as retail sales, employment, housing construction and auto sales."

To achieve lower interest rates in general requires a reversal of some or all of the factors that have made the complex of interest rates high in the first place. Standing on the top of Capitol Hill and shouting at financial markets or ordering interest rates to fall will no more succeed than did King Canute, who tried to give orders to the ocean tides -- unless, of course, Congress and the Federal Reserve, the creature of Congress, change the policies that have caused high interest rates. I shall return to this theme at the end of my remarks.

There are many different varieties of interest rates. Interest rates may be classified by maturity, by default risk characteristics, by borrower, and so forth. To be sure, public policy measures can be taken that lower this or that individual interest rate -- for example, by explicit subsidy, or by implicit subsidy as in the case of tax-exempt municipals and government guarantees of private debts. These subsidies initially either lower the after-tax costs to borrowers or increase after-tax returns to lenders, thereby inducing lenders to shift funds to these from other uses. Unless the total supply of credit is somehow increased, more credit to subsidized uses means less credit to unsubsidized uses.

The lower rates and lower borrowing costs for subsidized loans are inevitably linked to higher rates and higher borrowing costs for unsubsidized loans. However, there is more than an equal swap of some higher rates for some lower rates. Because the supply of credit is used less efficiently, some credit is put to less efficient use. The result is that even though some highly visible individual interest rates may fall, the average effective cost of funds increases.

I may add that the vast number of federal subsidies for some forms of borrowing leads to wasteful use of credit and is one of the main reasons why interest rates are now so high, especially for nonsubsidized borrowers.

By the same token, given the supply of credit, restrictions on (or additional taxes on) the use of borrowed funds for specific uses effectively increases costs for some uses and denies funds to other uses. Credit will tend to flow away from these controlled uses to alternatives, perhaps lowering rates in other areas.

The possibility of changing specific interest rates is, of course, a great incentive for some borrowers to use political means to alter market alternatives, in effect, to use government to slice up the credit pie in their favor at less than market rates. Again, the inevitable result is higher rates for the remaining reduced supply. Other borrowers are effectively stuck with higher costs, and lenders do not necessarily receive higher returns. Widening the range of controls and interest subsidies only makes the rigged system even more burdensome, wasteful and costly.

It should not be necessary to repeat that private sector borrowers do not incur debt and pay the interest on the debt for frivolous reasons. Individuals balance costs and benefits in their spending decisions. By the same token, private sector individuals and businesses do not incur interest costs unless the added benefits justify the added costs. What is effectively an ongoing auction in the market system is an intregal part of the free market mechanism that channels resources, including credit, to their most efficient uses. This is why directing resources from high productivity uses to low productivity uses lowers over-all productivity and output.

It may be tempting to label somebody else's uses of credit as non-productive but there seems little objective justification for the label "non-productive" if private individuals and businesses use or pledge their own assets. To be sure, many individuals make "mistakes" in the sense that they borrow in anticipation of a profitable outcome, where returns exceed borrowing costs, only to discover, later, that returns fall short of borrowing costs. Such "mistakes" are inevitable in a free market profit and loss system.

However, the market system assures that such "mistakes" are self-correcting, self-limiting, and are not systematic. Unfortunately, there are no such incentives or constraints on controls or regulation or government subsidies. Indeed, the tradition of governments is to keep sending more and more good money after bad.

If "non-productive" means, as above, that returns do not justify costs, why then is regulation or controls required to achieve what is in the best interests of private sector transactors? Surely private borrowers and lenders know their own circumstances better than distant government officials. Certainly private borrowers and lenders have stronger incentives to avoid wasting or endangering their own resources compared to a federal nanny -- who may have other axes to grind or serve other interests or objectives, including their own.

For hundreds of years there have been recurring efforts to label some private uses of credit as non-productive even when people use their own assets or pay borrowing costs themselves. Typically, as in H.R. 6124, non-productive is not defined or demonstrated, so it usually comes down to a use of credit that is not understood, or not popular, or perhaps credit that can be seized, expropriated or diverted by the government as credit allocation becomes a political rather than a market process. In the case of H.R. 6124, corporate takeovers are the only example given of "non-productive" credit.

Labeling something doesn't necessarily make it so, including calling corporate mergers and acquisitions "non-productive". Mergers and acquisitions are important guarantors of management efficiency. When the management of a corporation is not doing its job properly, one way to replace the management is for outsiders to acquire the corporation and replace the management. Enhanced profits and capital gains are the incentive for the acquiring corporation. In principle, borrowing funds for an acquisition of this kind is no different than buying a productivity enhancing machine on credit. To be sure, not all machine purchases turn out well and neither do all corporate mergers.

Many corporations are launched, and their products and markets are developed, with a view towards eventually selling the corporation. This is true for small innovating business firms, where the bulk of new ideas and new jobs are created, as well as for closely held or family corporations, owners of which wish to retire, diversify, or change activities. Other corporate acquisitions and mergers reflect attempts to make more efficient use of plant know-how, gain access to better markets or better management, achieve economies of scale, and the like. Also, from time to time many corporations wish to restructure their activities, shedding some products and markets in order to focus on others.

Limiting the merger and acquisition abilities of these corporations will mean lower prices for their stocks, less innovation and invention, and fewer jobs. Restricting mergers and acquisitions by credit controls will also restrict entry and retard productivity enhancing technology production, technology transfer and market flexibility.

This resulting impaired productivity and loss of jobs is the inevitable consequence of restricting mergers and acquisitions and would be an excellent,

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but regrettable, textbook example of a non-productive act.

It is also important to recognize that when a corporation is acquired for cash, even assuming that all the cash is borrowed, this is not the end of the credit line. The sellers, who formerly owned corporate stock, do initially hold cash. In that sense, they are no different than individuals who sell any stocks or bonds, even ten shares of IBM or AT&T. After all, money is the medium of exchange. However, sellers of stock typically hold the received cash only temporarily. Instead, the cash is used mainly to buy other securities or is otherwise invested. When the funds are invested, the funds initially borrowed by the acquiring corporation are made available to other borrowers, or to other segments of the market. Money and credit are fungible.

Corporate mergers are certainly not the reason for high and volatile interest rates. It borders on scapegoating to blame high interest rates on merger activities or to suggest that impeding mergers and acquisitions will somehow lower interest rates for potential homebuyers, for new business, for farmers or others.

The lives and property of each one of us are closely tied to credit and to credit markets. This is why our liberties, as well, are also linked to financial markets. Giving the Federal Reserve Board, or any other government agency, control over the quantity and price of credit, is more than a danger to our productivity, it would be a serious threat to our personal freedoms.

The one sure way to reduce interest rates is to reverse the public policies that have caused them. The text for the day should be from that wise philosopher and economist, Pogo, who noted, "We have met the enemy, and he is us". Through the years Congress has enacted a tax code that is severely biased against saving and investment. This is one of the reasons Americans save and invest such a small fraction of their incomes. At the same time that the tax code penalizes saving and subsidizes consumption, higher and higher levels of government spending also subsidizes consumption and diverts resources from saving and capital formation and other productive uses. Running huge deficits to finance such bloated budgets add their own push towards higher interest rates.

The main reason for high interest rates is the rising tide of inflation. To be sure, there are waves of faster and then slower rates of inflation but the overall trend of inflation has been sharply higher for close to twenty years.

The main reason for inflation is excessive creation of money by the Federal Reserve, which is accountable to Congress. The only way inflation can be restrained or eliminated is to slow the increase in money. Because fast money growth causes inflation, and in turn, inflation increases interest rates, easy money leads to tight credit. Similarly, because slowing money growth results in lower inflation, and lower inflation eventually causes interest rates to decline, tight money leads to easy credit.

These effects are strengthened by the bracket creep, the impact of inflation on tax rates. With more inflation, taxpayers are pushed into higher brackets. This means that savers pay a larger and larger fraction of their interest receipts in taxes, lowering their after-tax returns. Thus, bracket creep is an independent source of enhancing the tax bias against saving and thereby contributes to higher and higher interest rates.

To sum up, many of our citizens do have serious problems with high interest rates. Ignoring fundamental causes of the high interest rates and adding a new set of controls will not solve our problems or theirs, but merely add to them. Instead, I would strongly urge the Congress to undo the policies that have created the high interest rate problem in the first place, by requiring slow and steady money growth, by reducing expenditures, especially those that subsidize consumption, and by prudent tax reduction that lessens the tax bias against saving and investment.

Finally, I note that during much of the 18th century, the age of Mercantilism, it was widely believed that only farming was productive. With the aid of hindsight and the wisdom of Adam Smith, we all realize how badly Mercantilism performed and how Mercantilism stood in the way of the improvement in the lines of ordinary people at that time. Yet some of us propose a reactionary return to a twentieth century version of the same Mercantilism. The New Mercantilism will serve us no better than the old, and I urge you to reject it.

A REVIEW OF THE MARCH 14, 1980
IMPLEMENTATION OF THE CREDIT CONTROL ACT OF 1969

Prepared by the
Economic Policy Division
The Chamber of Commerce of the United States

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Introduction

In March 1980, following several months of acceleration in the Consumer Price Index (CPI), the President announced a broad program to moderate and reduce the rate of inflation. As part of the program, the President authorized the Federal Reserve (Fed), under the terms of the Credit Control Act of 1969, to take actions to restrain specific types of credit.

In its announcement of the specific actions to be adopted in support of the President's program to reduce inflationary forces, the Fed stated that "Consistent with that objective and with the continuing intent of the Federal Reserve to restrain growth in money and credit during 1980, the Federal Reserve has, at the same time, taken certain further actions to reinforce the effectiveness of the measures announced in October of 1979."

As implemented, the March 14th actions represented one of the most far-reaching sets of credit controls ever introduced into a peacetime economy. Their immediate effect on financial markets was one of shock, confusion and turmoil; interest rates soared, bond and stock prices collapsed and credit was unavailable to many borrowers at any price. This was quickly followed by acute monthly declines in measures of real economic activity such as retail sales, employment, housing construction and auto sales.

By the time the controls were removed in July, there were mixed views on both the need for and success of these actions. However, because of their relatively short duration and the current view that the recession is ending and the rate of inflation has moderated, interest in the effects of the program appears to be waning, largely, perhaps, because of uncertainty over its impact on prices and economic activity.

In an effort to fill this analytical void, this paper will attempt to evaluate the effects of the program by addressing three questions regarding the programs implementation. First, was it a necessary action in light of the economic trends at that time and the Administration's macroeconomic objectives? Second, was it effective in reaching those objectives? And third, quite apart from whether its intended effects were attained, what other effects on economic trends did the controls have?

In addressing these questions, this paper will review and evaluate the following sequence of events:

1. Economic activity and monetary policy prior to October, 1979.
2. Initial effects of the October 1979 actions.
3. The state of the economy just prior to the Fed's March actions.
4. A description and selective evaluation of the Fed's March actions.
5. The initial impact of the March actions on financial markets and real economic activity.
6. The current and expected future state of the economy as a result of the March actions and prior Fed policies.

Economic Activity and Monetary Policy prior to October 1979

Based upon annual changes in the money supply (M1A), monetary policy over the past recovery and business expansion from early 1975 to late 1979 was highly expansionary. From a base rate of growth of 5.5%

over the period 1975:IV to 1976:IV, M1A growth rose by 7.7% in the period 1976:IV to 1977:IV and by 7.4% over the period 1977:IV to 1978:IV. Following some short-lived efforts to reduce growth near the end of 1978 and the beginning of 1979, growth in M1A accelerated to a rate of 7.7% from 1979:I to 1979:III. With the exception of 1972, when M1 grew at 9.1% from December to December, the monetary growth rates over 1977, 1978 and most of 1979 were well above our historical experience.

Coinciding with this rapid monetary growth over the expansionary phase of the business cycle was a sharp acceleration in inflation. After decelerating to an annual rate of increase of 4.8% over calendar year 1976, the last year of moderate growth in the money supply, the yearly change in the CPI went to 6.8% in 1977, 9.0% in 1978 and soared to 13.3% during 1979.

The excessive growth in money over most of 1979 is especially startling inasmuch as inflation was running at an annual rate in excess of 12% in every month of that year and was widely recognized as the nation's major economic problem. While the excessive growth in money through early 1978 may be explained as part of the effort to promote rapid recovery from the recession of the mid-decade, there is no comparable justification for the subsequent excesses, particularly when the Fed's major objective since late 1978 was to restore price stability to the economy.

Part of this dichotomy between intent and action can be explained by the defective procedures used by the Fed to implement monetary policy.

Although the Fed formally adopted monetary aggregates as its major policy concern in the early 1970's, it continued to use interest rates as the targets to achieve the desired aggregates. Thus, if it wanted to slow monetary growth, it would seek to implement this policy by allowing the federal funds rate to rise to a higher level under the assumption that higher interest rates implied greater monetary stringency. However, if carried to the extreme, such a procedure is inherently defective in that factors other than monetary aggregates also influence the target interest rates. If the influences of these other factors are not adequately considered, monetary policy may drift from its intended direction and act to fuel the inflationary pressures in the economy.

Suppose, for example, that the Fed wishes to slow monetary growth and attempts to do this by establishing a higher target range for the Fed funds rate. Its subsequent open market operations would then be designed to keep the fed funds rate within this range. If at the same time increased credit demands or changed inflationary expectations were such as to increase market interest rates, the fed funds rate included, the Fed would respond by inadvertently accommodating this increase in demand through an injection of more reserves into the financial system. As a consequence, monetary policy will become expansionary when it should be restrictive.

This behavior appears to have characterized the operations of monetary policy through the first nine months of 1979. Despite expressions of deep concern for the worsening inflation and the realization that monetary aggregates were consistently exceeding the upper bound of the desired rate of growth, the target ranges for fed funds were raised only gradually during the periods and failed to keep pace with the rising credit demands and inflationary expectations. Over the period of March, 1979 to August, 1979, when monetary growth was running at a annual rate of 8.5%, the Fed funds target range was held essentially constant until the end of the period. From March 20th to July 11th, the range was unchanged at 9 3/4% - 10 1/2%. On July 27th, it was raised to 10 1/2% - 10 3/4%, and then to 10 3/4% - 11 1/4% on August 14th.

Although growth in M1A slowed somewhat to 6.8% in August and 6.4% in September, this decrease in growth was rather modest, and, coming at the end of two and a half years of excessive monetary growth, could not begin to have any substantive influence in the inflation experience until many months into the future. Commenting on 1979 economic trends and monetary policies in an article in the October 1979 Federal Reserve Bank of St. Louis Review, Keith M. Carlson noted: "The rapid growth of money in the third quarter of 1979 will tend to dampen the decline in output, but eventually result in further upward price movements."

The Federal Open Market Committee apparently came to the same realization at essentially the same time when it announced a new series of policy measures to "assure better control over the expansion of money and bank credit." The most significant of these actions was the approval of a change in the day-to-day procedures used to conduct monetary policy.

As reported in the October, 1979 Federal Reserve Bulletin:

> "This action involves placing greater emphasis in day-to-day operations on the supply of bank reserves and less emphasis on confining short-term fluctuations in the federal funds rate."

* * *

During this period of overly stimulative monetary policies, real economic activity was beginning to slow. Following real GNP growth of 4.8% from the fourth quarter of 1977 to the fourth quarter of 1978, growth turned slightly negative in the first half of 1979, partly as a result of the sharp increase in oil prices and brief shortages in supplies caused by the revolution in Iran. Real growth bounced back to 3.1% in the third quarter of 1979 but this mostly reflected the pent up demand from the previous energy uncertainties. Retail sales followed a similar course, rising at an annual rate of only 2.9% from February to July, but surging 44% from July to September. Several of the durable goods sectors were in an unmistakable downtrend, however. Housing starts and sales of new and existing homes had peaked in 1978 and were gradually trending down through the first three quarters of 1979, declining 15% from the 1978 level. Similarly, auto sales during 1979 began to gradually decline from the peak rates of 1978. Industrial production was essentially unchanged over 1979.

Continued high interest rates and accelerating inflation were beginning to have a dampening effect on economic activity. Inflation, however, was not abating. After increasing at an annual rate of 13.1%

from February to August, it accelerated to 14.5% in September. For the year as a whole, 1979 marked the worst peacetime inflation experience since 1920.

Initial Effects of the October 6, 1979 Action

In early October, when it became apparent that Fed money management procedures were failing to restrain money and credit growth and that inflation was nearly out of control, the Fed announced, on October 6, 1979, a major change in its technique for implementing monetary policy that relied on bank reserves rather than the federal funds rate. In addition, the Fed raised the discount rate to 12% and established a marginal reserve requirement of 8% on increases in the managed liabilities of member banks.

The effect of this new policy on monetary growth, financial markets and economic activity was immediate. The money supply (M1A), which had grown at an annual rate of 7.9% from February to September, grew at only 4.6% in the last quarter of 1979. As would be expected, financial markets quickly exhibited all of the symptoms of a classic credit crunch. Ninety day T-bill rates rose from just under 10% in September to 13% by the end of October before stabilizing at around 12% near the end of 1979. The prime rate went from 13.5% to 15.75% over the same period.

Total bank loans, which had been advancing at a 16.2% rate over the first nine months of the year, grew at only 3.5% in the last three months. Commitments for residential mortgage loans were down 15% from their year ago levels.

Overall economic activity began to slow appreciably, while credit-sensitive consumer goods declined precipitously. Housing starts and sales and auto sales fell sharply over the final quarter of 1979, while the decline in existing home sales in November and December was the steepest in the history of that series. Growth in total retail sales slowed to 2.5% in the fourth quarter compared to 11.5% during the first three quarters of the year.

In sum, the decisive actions taken by the Fed were having a moderating effect on financial markets and economic activity.

The state of the economy just prior to the Fed's March actions

Although real economic activity and money and credit aggregates did slow significantly, the inflation experience worsened, primarily due to the lagged effect of the earlier monetary growth. In the last quarter of 1979, the CPI advanced at a 13.7%, a half a percentage point greater than the rate of increase during the first nine months. But in January and February, the CPI accelerated to an annual rate of increase of 18.1%.

Combined with this worsening price experience was growing uncertainty about the immediate direction of economic activity. Although housing starts and sales continued to fall, changes in total retail sales were erratic. Such sales rose at an annual rate of 43% in January, no doubt reflecting aggressive post-Christmas mark downs and price conscious shoppers, but declined 20% in February.

In financial markets, the severity of the crunch was worsening. Ninety day T-bill rates and rates on high grade corporate bonds increased 200 basis points over the first two months of the year and the prime rate inched up to 16.5%. Mortgage credit markets tightened further; new residential mortgage commitments in January and February were down 20% from the year ago level.

Despite this severe crunch environment, the worsened inflation experience apparently panicked the Administration into believing that it had to further demonstrate its willingness to take immediate and decisive action, regardless of costs or impacts. To this end, it adopted a broad series of anti-inflation policies, a key component of which was providing the Fed, under the terms of the Credit Control Act of 1969, with the authority to impose certain restraints on the extension of various types of credit, as well as other measures.

In a later analysis of its special credit actions, the Fed cited the acceleration of bank loans and commercial paper issuance as factors "threatening achievement of the restrained growth in money and credit in 1980 which was deemed necessary to help curb inflation", and later added "In this environment, a supplemental program to restrain loan growth seemed appropriate, so long as the burden of the restraint did not fall on those classes of borrowers least able to bear it."

* * *

Inasmuch as early 1980 loan trends represent one of the major action-forcing events precipitating the credit controls, some explanation of the increase is appropriate at this point in the paper. As noted earlier, the October actions created considerable turmoil in financial markets and contributed to a sharp reduction in loan demand, partly in response to the uncertainty then pervasive in the markets. As credit conditions stabilized in December and the outlook became somewhat more certain, many firms that had delayed borrowing reentered the market to obtain the funds necessary for operating their businesses. Such actions can create substantial short-run changes in credit demands that are not necessarily indicative of an incipient sustained credit expansion. Convergence to market equilibrium typically involves over-and-under-adjustments, especially when the market has been temporarily destabilized by sharp changes in government policies.

Another important influence on the January/February loan expansion, was the widespread anticipatory borrowing by business and financial firms in the expectation that some form of credit controls might be imposed. The worsening inflation experience certainly suggested that further, dramatic actions might be taken. This possibility was acknowledged by the Fed in its July 22, 1980 review of the program and receives further confirmation from both bankers and financial-oriented trade associations who noted that they received a great many inquiries from customers and others regarding the possibility of controls and what sort of actions they should take to assure access to needed credit. The 40% annual rate increase in unused bank commitments from December to February, in the face of record high interest rates and declining economic activity, suggests that much of the demand was defensive nature.

Once the fear of controls passed, these commitments and bank lines would lapse unexercised.

Finally, sharp changes in monetary policy and downturns in economic activity can lead to an increase in bank loans and other forms of short-term credit. As aggregate demand falls off and profits and revenues decline, business firms need greater amounts of credit to fund excess inventories. Sharply higher interest rates temporarily discourage long-term borrowing to fund planned investments, and force firms to rely more heavily on bank credit until long rates fall to more acceptable levels. The near absence of long-term mortgage credit for completed commercial real estate projects, for example, necessitated greater reliance on short-term loans until long-term funds became available.

Turmoil in credit markets often leads to massive shifts in funds from one investment medium to another as investors take advantage of higher yields in different markets. Those institutions that are at a competitive disadvantage in such a market lose funds and must turn to bank loans to cover previously made commitments. As an example, life insurance companies had to significantly increase their short-term borrowing in early 1980 to cover their loan commitments made at an earlier date. This increased borrowing was not a reckless expansion of credit but a necessary response to a severe outflow in funds caused by increased policy holder borrowing and various forms of cash surrender. A sample group of life insurance companies increased their net borrowing by $1.2 billion in the first quarter of 1980 compared to $256 million in the same quarter last year.

In summary, a substantial portion of this early 1980 credit expansion was the result of necessary defensive measures by business firms and financial institutions attempting to recover from the credit policies implemented in October. Such credit expansions tend to be short-lived and have little or no influence on the future course of inflation.

A Description and Selective Evaluation of the Fed's Credit Restraint Program of March 14, 1980

The Credit Restraint Program (CRP) announced March 14, 1980 consisted of the following specific restrictions on credit flows:

- Growth in bank loans should not exceed the upper part of a range of 6 to 9%.
- A special deposit requirement of 15% for all lenders on increases in certain kinds of consumer credit.
- An increase from 8% to 10% in the marginal reserve requirements in managed liabilities.
- Restraint on the amount of credit raised by large non-member banks by establishing a special deposit requirement of 10% on increases in their managed liabilities.
- Restraint on the expansion of money market mutual funds by establishing a special deposit requirement of 15% on increases in their total assets.

Before discussing the impact of the CRP on economic activity, a few observations on the structure of these restraints as well as their enforcement and implementation are worth noting.

At first glance, the 6 to 9 percent growth target for bank loans appears to be reasonable when considered in light of desired, long-run rates of credit expansion. But as a short-run objective, attempts to meet it quickly could cause severe dislocations for some firms, particularly insofar as many banks were pressing against these limits just prior to the implementation of the CRP. In its July report, the Fed noted that in the first quarter, a number of banks were already close to the ceiling for the entire year, while others were exceeding it at an annual rate. Thus, to meet the required targets, some banks might have to cease lending entirely. While this can have a rather adverse impact upon the bank, the severest impact falls on those customers for which the bank is essentially the only source of credit. Because of the turmoil in securities markets, the number of such potential customers was clearly growing during the period.

Inasmuch as most business loan extensions are based upon a previously made commitment, either formal or informal, these limits can create substantial customer hardships in the short-run. With a loan commitment, a business firm can contract with suppliers and other business firms to complete its investment and expansion plans, drawing down on the commitment when funds are required to pay for the delivered goods. In the interest of meeting its targets, the need to nullify these commitments apparently did not trouble the Fed. On the contrary, in explaining the program through the format of Q's and A's, in response to the hypothetical question of coping "...with takedowns of legally binding commitments that would push the bank's overall loans over the limit", the Fed responded "...banks should review existing commitments carefully to determine which are, in fact, legally binding."

This statement suggests, perhaps, that commitments of lesser formality might be dishonored in the interests of meeting the targets. One can easily imagine what this implies for effective business planning.

The Fed's extension of reserve requirements to increased assets at money market funds (MMF) emphasizes how controls beget other controls and the extent to which regulatory inequities and inefficiencies are often resolved by spreading inequities rather than getting rid of existing ones. In and of themselves, MMFs create no credit -- they merely serve as intermediaries between the investing public and the banking and financial system. They are, in effect, the creatures of a regulatory system that requires banks and thrifts to pay no more than 5.5% interest on their deposit accounts. The MMFs exist, in large part, because individuals of moderate means, tired of receiving a below market return on their savings as well as a return below that received by people of means, were willing to look elsewhere and found relief in these funds. Having the responsibility of enforcing one set of controls that have diminished the usefulness of existing financial intermediaries, the Fed felt, in the interest of equity, that similarly inefficient controls should be extended to the competing entities as well.

It is also ironic that, inasmuch as rapidly growing consumption expenditures and depressed rates of saving have contributed to the adverse inflation experience, the Fed would take steps that would further diminish the incentives to save by artificially decreasing the yield that these funds can offer savers at a time when greater savings should be encouraged.

In an effort to make the controls program more palatable, the Fed stated that auto credit and home mortgages should be treated normally. Banks were encouraged to maintain the availability of funds to small businesses, farmers, homebuyers and others without access to other forms of financing. Although banks may have shown greater willingness to lend in these areas, it takes more than a supply of credit to preserve activity in a specific business sector. The shock of the program so altered expectations and increased uncertainty that activity in these already fragile sectors plunged even further. With construction loan rates above 20%, there was not much interest in constructing residential dwellings. And with long-term mortgage credit at 16%, in the rare instances when it was available, there was not much interest in buying what little was being produced. Similarly, rising fears about employment prospects and other uncertainties induced by the CRP served to discourage the purchase of an auto, even if credit was available. For small businesses, despite the existence of special programs, the Fed notes in its July report that the experience was mixed.

Credit card usage came under special pressures, not only because of the 15% reserve requirement, but also because the impact of the CRP gave banks an opportunity to implement fees and costs, accelerate payments and cancel costly card accounts in order to bolster the future profitability of their credit card systems. These were actions that could not have been taken in a more stable market because of competitive pressures. While difficult to estimate at this time, these costs to the consumers are likely to be substantial.

The Initial Impact of the March Actions on Financial Markets and Real Economic Activity

The effect of the CRP on financial markets was immediate and severe. From the end of February to the middle of March, rates on ninety day T-bills jumped 150 basis points, and increased another 120 basis points during the last two weeks of the month. Over the same period, the prime rate increased 350 basis points to 20%. Growth in bank loans immediately turned negative, falling, at annual rates, by 0.8% in March, 4.2% in April and 13.5% in May. For the second time in six months, stock and bond prices collapsed, leading many analysts to write obituaries for the bond market as it has existed for more than a century, and for the fixed rate debt instruments used to finance long-term business investment.

Economic activity also declined precipitously in the months following the implementation of the CRP. Real GNP during the second quarter plunged 9.1% at a seasonally adjusted annual rate, the second sharpest decline in the postwar era. As dramatic as this drop was, the declines in a number of the component sectors were at rates or in volumes that exceeded or challenged many past records. In March, housing starts fell by more than in any other month in twenty years, auto sales were running at their lowest rate in twenty-two years, total retail sales fell at the fastest rate in twenty-nine years, the rise in unemployment in April and May was the most for any two month period since the Great Depression. May and June's decline in consumer installment debt was the largest on record, and construction spending fell by more in one month than it had at any time in the past thirty-six years.

Corresponding to the decline in economic activity was a sharp fall in the rate of inflation. The increase in the CPI dropped from an annual rate of increase of 18.1% in the first quarter to 11.6% in the second. The rate of increase in the producer price index declined even more as did a measure of the CPI that excludes the volatile components of energy, food and housing.

While the severity of the decline in economic activity was certainly extreme and could lead to further problems in the months to come as business and consumers attempt to adjust to the shock of the CRP, an analysis of the relative rates of decline of the major components of GNP offer other troubling signs of future problems.

Typically, the major factors contributing to a severe recession are declines in consumer and capital spending. Declines in inventory investment, while capable of precipitating a recession and causing a sharp quarterly reversal in growth, tend not to lead to severe recessions. For example, the decline in real GNP in the first quarter of 1975, which came at the end of the last recession and was the only quarterly decline of the postwar era that exceeded the rate of decline experienced in the second quarter of 1980, was largely due to a massive drop in business inventories. Positive economic growth resumed in the next quarter and continued to advance for nearly four years. During that 1975 quarter, personal consumption expenditures increased at an annual rate of 2.3% while fixed investment fell 22%. In contrast, the decline in 1980:II was largely concentrated in fixed investment, which fell at an annual rate of 31%, and personal consumption expenditures, which fell 10.6%. Business inventories actually increased over the quarter.

These relative sectoral declines, the sort that often characterize a severe recession, are the kinds of economic deterioriation that one would expect to follow from the implementation of a program such as the CRP. Focused on financial markets, where resources are allocated for business investment, and including special restraints aimed specifically at the consumer, the program had its greatest immediate impact on the targeted sectors. As for its indirect and subsequent effects, these will not become apparent until later in this year and beyond.

For the longer run, the focus of the program on credit markets and investment seems particularly ill-conceived in light of the nation's problems of inadequate capital formation and meager productivity growth. Since there is widespread agreement among economists and policy-makers that a greater rate of capital formation is a high priority, it is ironic that a lack of patience in solving one problem, whose severity was partly attributable to inappropriate government policies of the recent past, led to the adoption of another set of policies that will hinder and delay the achievement of other pressing objectives.

In order to get an alternative perspective on the impact of the controls and to better estimate their likely, long-run effects, Data Resources, Incorporated was commissioned to do a study of the quantitative economic impact of the CRP. It should be emphasized that the findings are preliminary; in particular, the magnitudes need further verification through more detailed study. Nonetheless, to quote from DRI's own findings: "It is obvious from the result that the March 14th Credit Controls had some negative impact on the economy in the second quarter" . . . The credit controls did make the fall off in economic growth more severe."

According to the simulation, the effect of the CRP during the second and third quarters of this year was exclusively one of reducing real economic activity, not the price level. The observed decline in the rate of inflation during these quarters was evidently due to other factors. While the social cost of the CRP in terms of foregone output was small relative to the overall impact of the recession ($2.7 billion of a $9.1 billion decline in real GNP between the second and third quarter), the simulation shows no demonstrable benefit in reducing inflation during these two quarters or in succeeding quarters through 1982.

The major, and perhaps surprising, result of the simulation, however, is the expected impact of the CRP on the weak recovery forecast for 1981. The negative impact in calendar and FY 1981 is expected to be greater than the impact during the short period from March through July that the program was in effect. What was expected to be a sluggish recovery in real GNP growth of 1.1% in 1981 without controls is now expected to be much weaker. As a result of the CRP, growth in real GNP in 1981 is expected to be only 0.8%, 35% less than what would have occurred without controls.

Although the program had no demonstrable effects in reducing inflation, the simulation estimates that it will entail substantial social costs by the time it runs its course through the end of 1982. The DRI simulation suggests, albeit tentatively, that some of the social costs (and net loss to the economy as a whole) will have been the following.

GNP loss	$23 billion
Employment loss	300,000 man years
Federal Tax Receipt loss	$7.0 billion
New Car Sales loss (domestic)	500,000 units
Loss in total consumption	$19 billion
Loss in housing starts	50,000 units

Charts of the simulated results for selected economic variables are presented in the appendix to this paper.

Are the Problems Behind Us?

Beginning in June and July, many measures of economic activity began to bounce back sharply from the depressed levels of early Spring. Housing starts and sales, retail sales, durable goods production, factory orders, employment and the index of leading indicators all turned up, some at record rates, suggesting that a trough had been reached and that the recovery was underway. Together with the slowing of the increase in the CPI and the large declines in interest rates, there was some reason to believe that the program had been successful. Rather than dragging out the process of deflation through more traditional monetary restraint, the CRP, it was felt, contributed to a quick fix: A brief period of intense pain, followed by renewed, non-inflationary growth.

While this is one possible view, an alternative one is that these increases in activity are nothing more than an adjustment to the excessive declines of the second quarter, and that once some semblance of equilibrium is restored, the economic deterioration induced by the CRP will continue through the rest of 1980. For behind these early signs of growth are other indications that suggest a continuation of economic decline.

By mid-summer, once the immediate shock of the CRP had run its course, interest rates and prices began to rise. From a low point of 6.5% in the middle of June, the rate on ninety day T-bills rose to 10.03% by the end of August, while long-term residential mortgage rates increased from just below 12% to over 13% during the same period. If we are in a recovery, this would mark the first one in which interest rates rose in advance of a substantial period of business expansion. Similarly, the average annual rate of increase in producer prices jumped to approximately 20% in July and August, and this will lead to further escalation in the CPI.

Business inventories, which had been at cautious levels prior to the second quarter, worsened as a result of the decline in comsumption expenditures. The inventory-to-sales ratio increased from 1.40 in February to 1.53 by July. With inventories higher than desired and with the economic outlook still uncertain, it is likely that businesses will begin liquidating some of their stocks, and this will work to further depress economic activity during the remainder of the year.

The recent increases in interest rates, which have been substantial, are certain to dampen the business and consumer spending plans that will be required to initiate the recovery. The rise in mortgage rates, for example, will delay any recovery in the severely depressed housing market.

Conclusion

The placement of severe credit restrictions on an economy that was already two months into a recession can only be viewed as an excessive reaction to one or two months of unexpectedly bad reports on credit growth and prices, some of which were related to the earlier actions of the Fed and the growing fear that further controls would be adopted. The economy was clearly slowing down and the interest rate levels reached in early 1980 were more than sufficient to sustain the slowdown through the year.

While some temporary decline in the rate of growth in prices had been achieved in Spring, the inflationary pressures in our economy are still quite strong and persistent, and will require continued vigilance on the part of the Fed to prevent a new outburst once the decline in economic activity is reversed. Since the implementation of the CRP will not make this task any easier, and thus, can be viewed as having made little or no lasting contribution to the attainment of price stability, we merely paid a very high price for what may have been nothing more than a few months of temporarily depressed growth in the CPI.

Beyond the immediate impact of the CRP on economic activity, the very implementation of this program raises a number of important conceptual issues about the nature of government economic policy, particularly insofar as recent experience suggests a greater willingness on the part of policy-makers to resort to some form of controls on prices, wages and credit to achieve some policy objective, despite the accumulated evidence which indicates that all such controls create severe dislocations and misallocations and seldom achieve the desired goal.

Even when implemented in a more moderate form, credit controls still induce sharp changes in the behavior of businesses and consumers which, in turn, often lead to unintended instability. The economic system can more easily adjust to very high interest rates, which would follow from a more traditional use of monetary policy, than it can to some type of explicit controls. High interest rates discourage marginal borrowing and investment plans, but still permit the high priority expenditures to take place provided the borrower is willing to pay the price. With controls, however, credit allocation is essentially random, and the priority ranking of investment opportunities is violated. This, of course, leads to an [illegible]

Controls can also lead to permanent changes in business practices that will work to distort future economic relationships. Once implemented, business firms will always consider their reimplementation as a distinct possibility whenever the economic environment possesses characteristics similar to that of late 1979 and early 1980. In such cases, the increase in anticipatory borrowing and legally binding loan commitments by businesses taking [illegible] to protect their future operations would work to distort observed credit flows and make Fed monetary management that much more difficult during an already trying period. Under such circumstances, the Fed could not distinguish between an inflationary increase in credit caused by an expanding economy and a non-inflationary increase induced by fears of potential controls.

* * *

It has often been argued that the government is a major source of instability in the U.S. economy. Looking back over the last decade and the early part of the present one, this conclusion [illegible] inevitable. With this historical experience, to believe that we can learn from our mistakes is to simply delude ourselves about the political pressure that occasionally forces us to substitute [illegible] of the moment. The statements by the Fed in [illegible] new operating procedures and admitted its failure to have adequately controlled monetary growth over the first nine months of the year, bore a striking resemblance to similar Fed statements in 1973 following excessive monetary growth in 1972. Was anything learned in seven years?

We can pretend that the future will be different, but history tells us that this will not be so. Repeal of the Credit Control Act of 1969 would recognize this failing by taking from the government extraordinary powers that can only lead to harm.

APPENDIX

DATA RESOURCES, INC. 1750 K STREET, NW · 9TH FLOOR · WASHINGTON, DC 20006
202/862-3700

THE ELIMINATION OF THE MARCH 14 CONTROLS FROM THE DRI MACRO MODEL

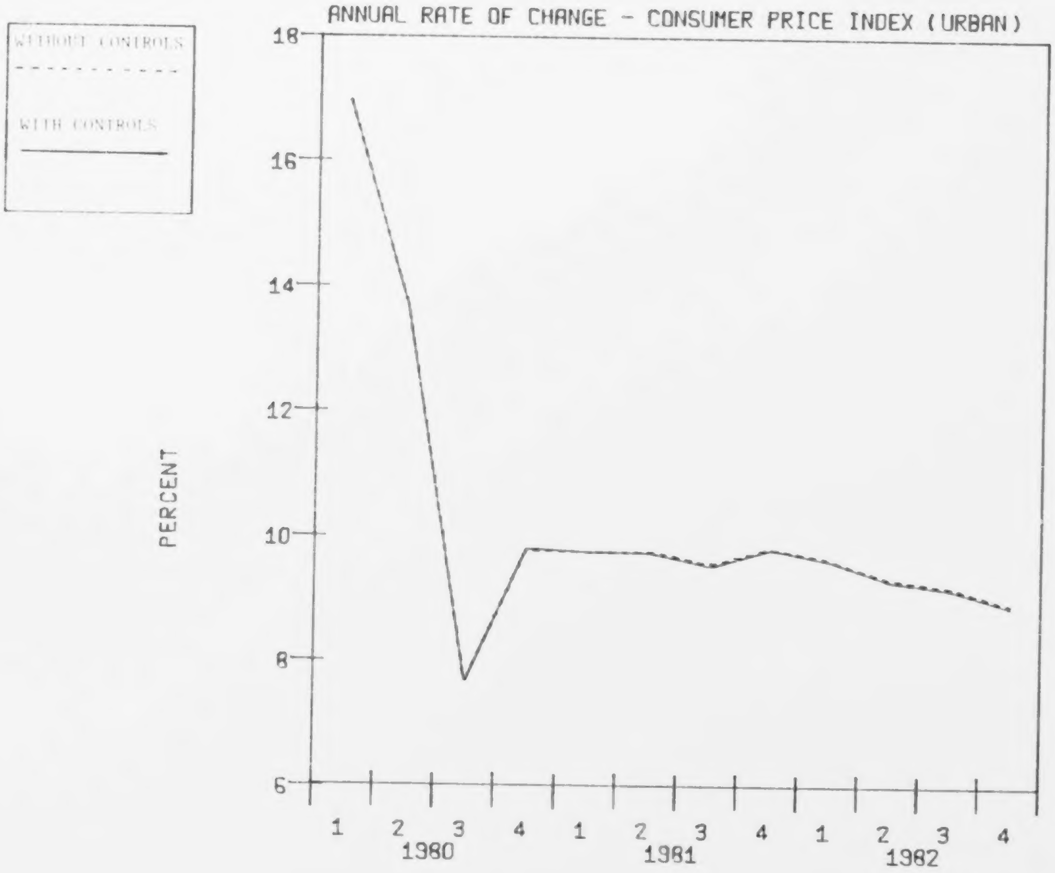
METHODOLOGY

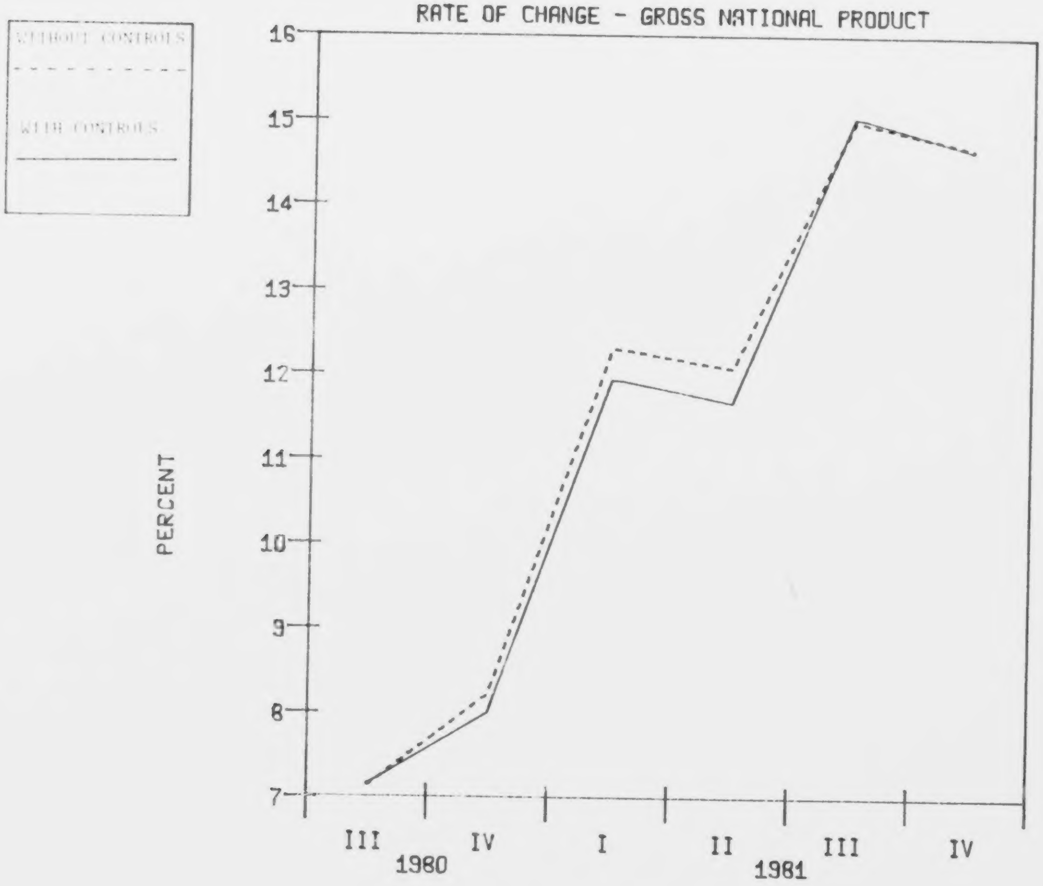
To create the base simulation, the latest forecast from DRI was used--WORKINGSOL090480. The major channel through which the FED's credit controls affected the macro model is in required reserves (RESFRBR). In this case it was the extra reserves on managed liabilities held by commercial banks that was required by the FED's March 14 credit controls action. This amount, in the second quarter, was estimated by the FED to be $0.75 billion. Using a reserve requirement lever (RRDT), required reserves were lowered in the second quarter by that amount, in order to eliminate this aspect of the controls. Another important aspect of the credit controls program was its effort to curtail unsecured consumer borrowing and the use of revolving credit by individuals. However, the controls were eliminated by the FED before any explicit costs, on a large scale, were put in place. Moreover, the restrictive lending terms adopted by the banks and finance companies cannot be explicitly placed in the macro model. However, it is assumed that much of the impact from the controls was on consumer sentiment, as measured by the Michigan Survey. Consumer sentiment is a variable in the model, JATTC, which can be explicitly moved. Choosing the pattern for what JATTC "would have been" without the controls was done by constructing three different paths. One, is the path chosen by the model, endogenously, when the change to RRDT was made. The second path is the actual JATTC for the second quarter and the remaining path for JATTC is from the latest DRI forecast (WORKINGSOLN090430). Third, is the path that JATTC was forecast to take before the imposition of the credit controls. This path was taken from control 022280.

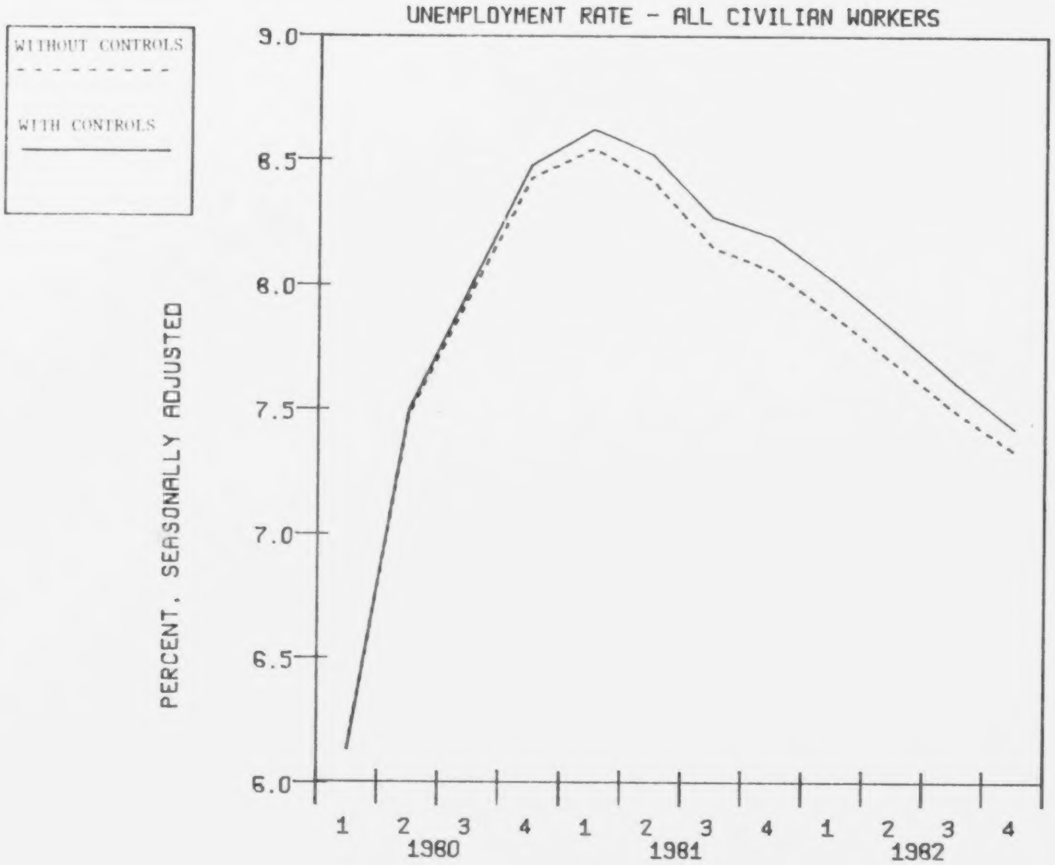
INTERPRETATION OF RESULTS

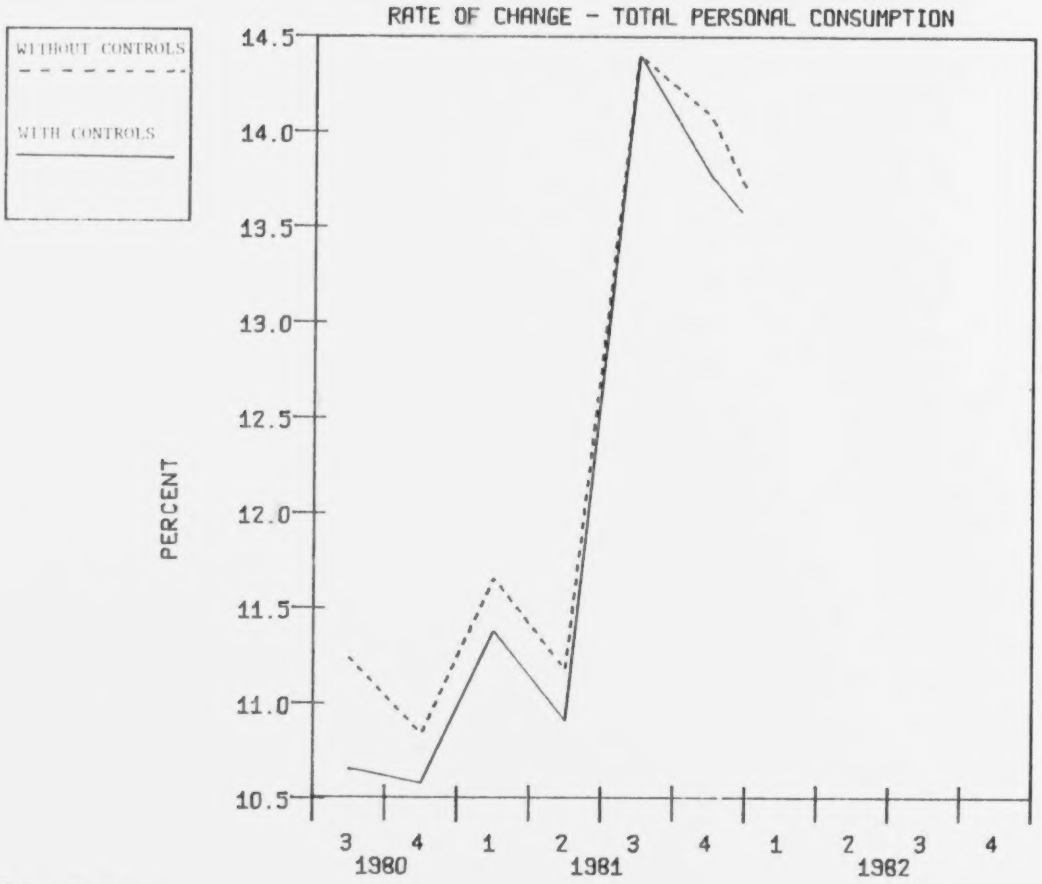
It is obvious from this analysis that the March 14 credit controls had a negative impact on the economy in the second quarter. However, the degree of that impact is questionable and could only be determined by a further detailed study. In attempting to establish a reasonable range within which this impact might fall, DRI has chosen a relatively optimistic projection of consumer sentiment (the level being forecast in February prior to the imposition of controls) and a relatively pessimistic projection (the level being currently forecast). While we feel that this is a reasonable way to approach the analysis, it must be stressed that the results are preliminary rather than conclusive.

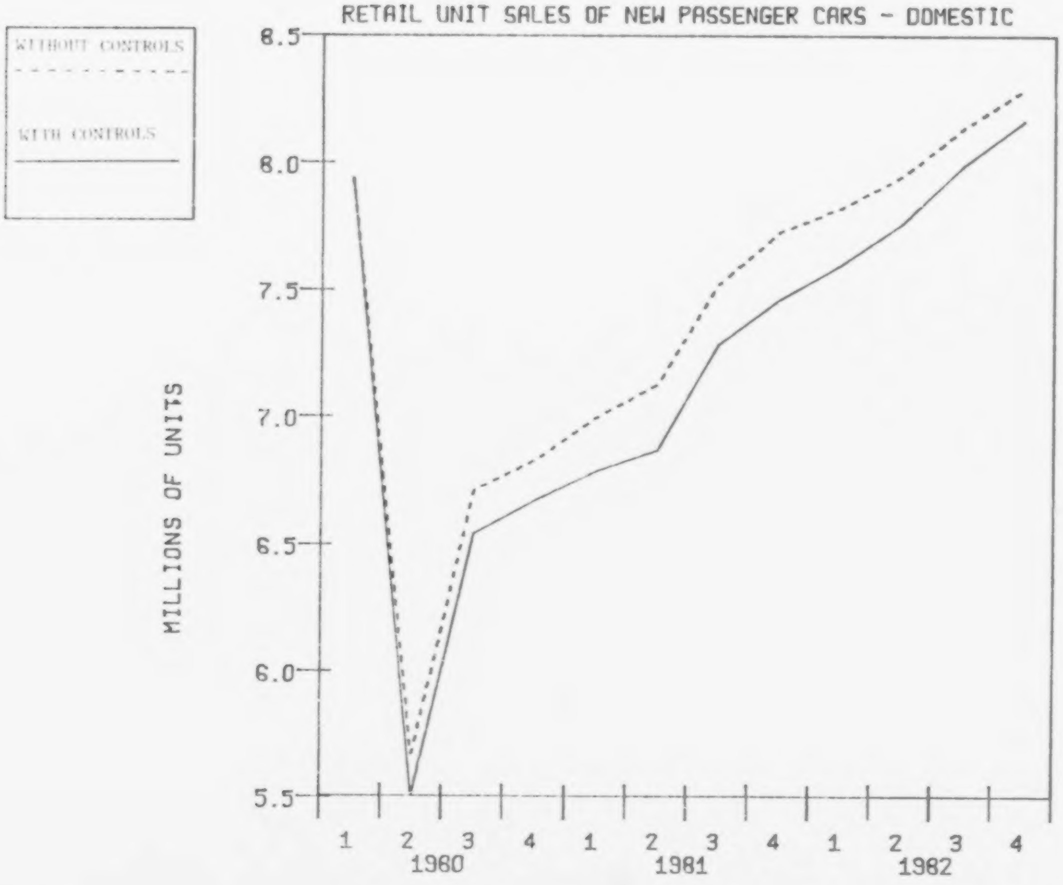
Moreover, it should be added that before the controls were put in place, DRI was projecting negative real economic growth for the second quarter, albeit far less severe than what actually occured and that consumers were already reducing credit use and banks were limiting consumer loans as far back as late 1979. In sum, although a turndown in the economy in the quarter was considered to be quite likely before the controls, the model illustrates that the credit controls did make the falloff in economic growth more severe. The negative impact seems to persist during the weak recovery that is forecast for 1981.


ANNUAL RATE OF CHANGE - CONSUMER PRICE INDEX (URBAN)
WITHOUT CONTROLS
WITH CONTROLS
PERCENT
18
16
14
12
10
8
6
1
2
3
4
1980
1
2
3
4
1981
1
2
3
4
1982

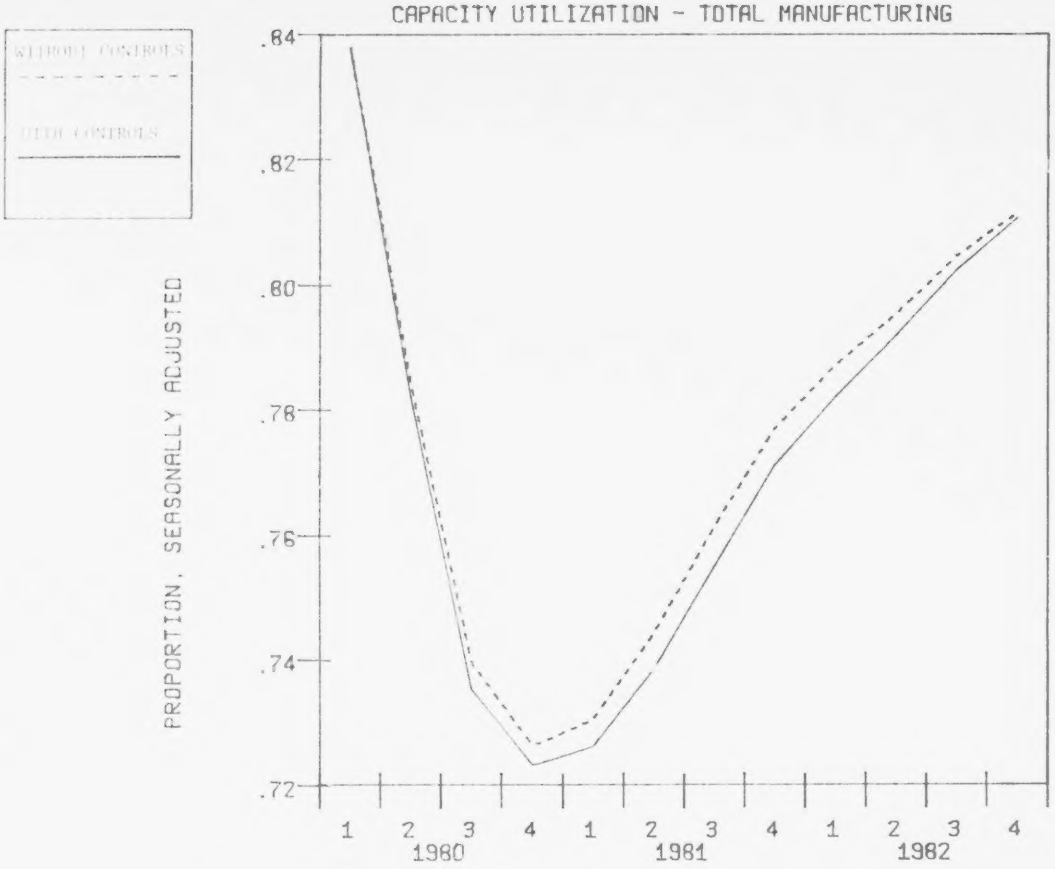

RATE OF CHANGE - GROSS NATIONAL PRODUCT
WITHOUT CONTROLS
WITH CONTROLS
PERCENT
16
15
14
13
12
11
10
9
8
7
III
IV
1980
I
II
III
IV
1981

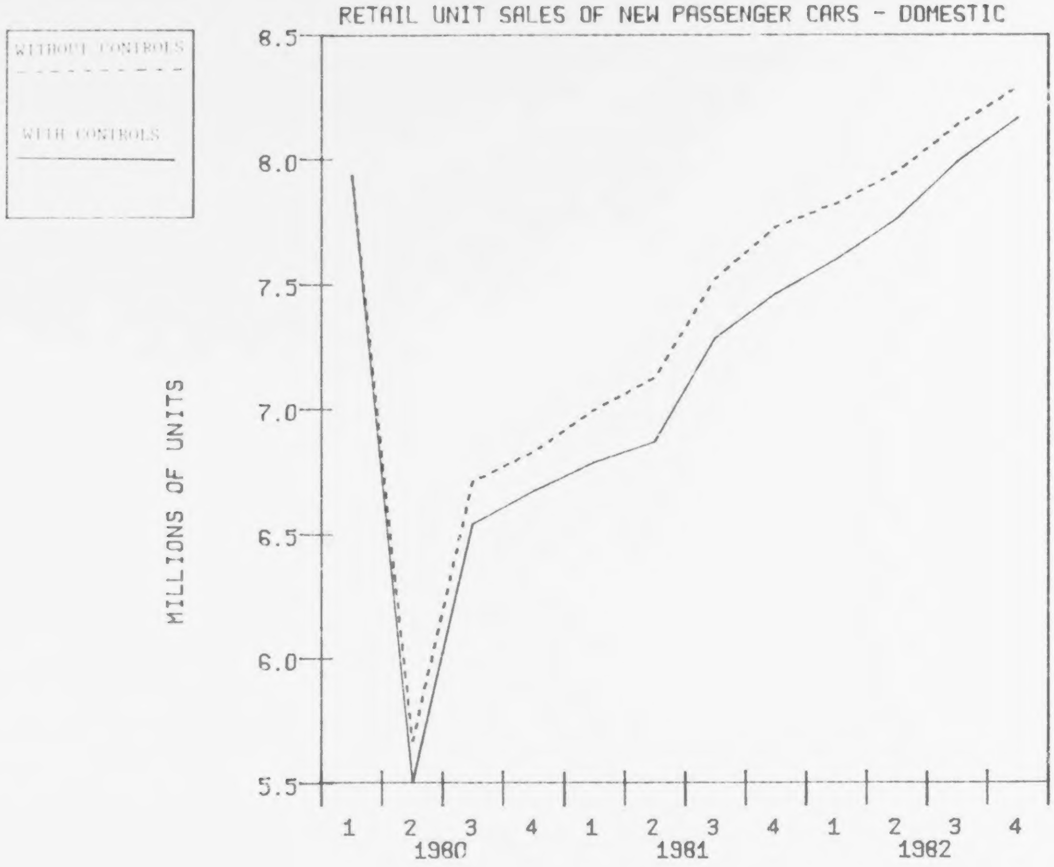

UNEMPLOYMENT RATE - ALL CIVILIAN WORKERS
WITHOUT CONTROLS
WITH CONTROLS
PERCENT, SEASONALLY ADJUSTED
9.0
8.5
8.0
7.5
7.0
6.5
6.0
1
2
3
4
1
2
3
4
1
2
3
4
1980
1981
1982


RATE OF CHANGE - TOTAL PERSONAL CONSUMPTION
WITHOUT CONTROLS
WITH CONTROLS
PERCENT
14.5
14.0
13.5
13.0
12.5
12.0
11.5
11.0
10.5
3
4
1
2
3
4
1
2
3
4
1980
1981
1982

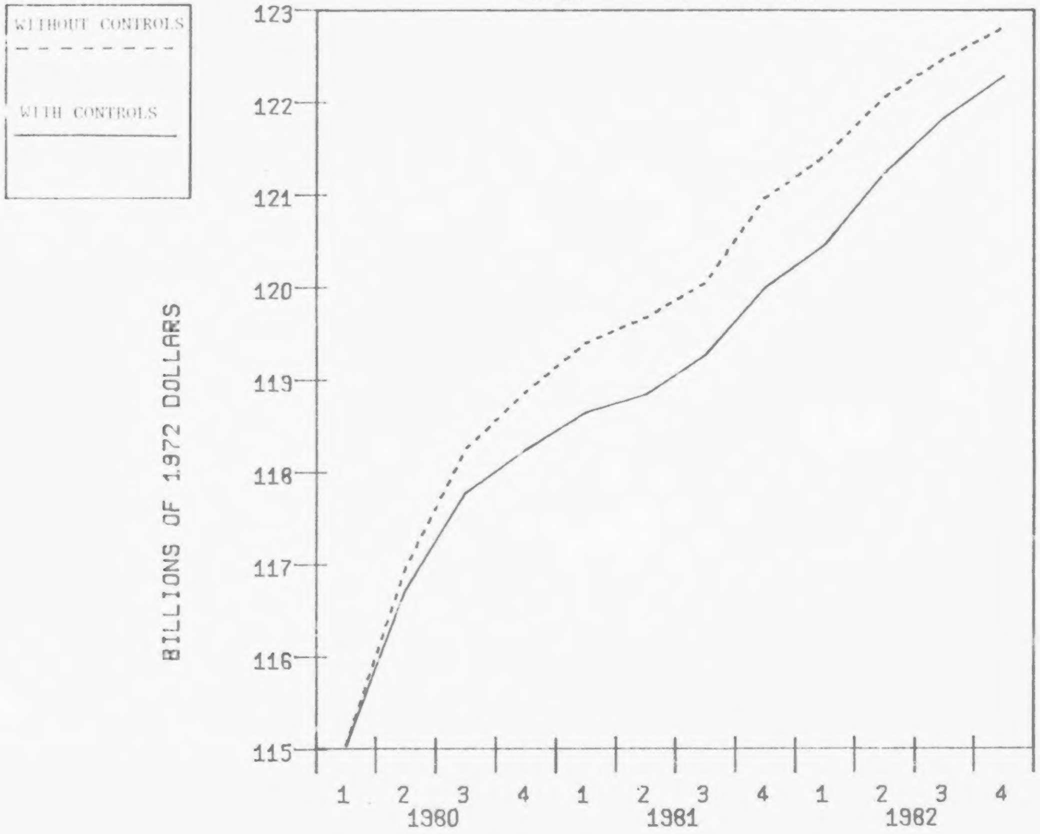


RETAIL UNIT SALES OF NEW PASSENGER CARS - DOMESTIC

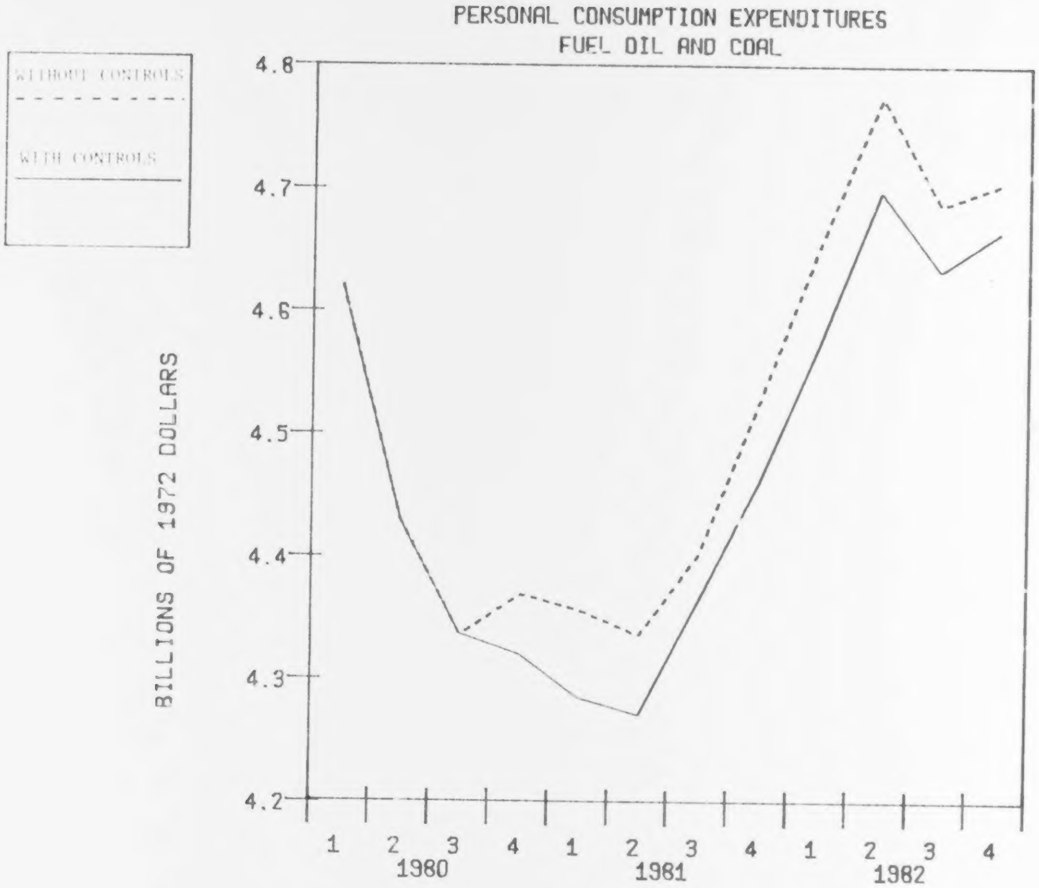

CAPACITY UTILIZATION - TOTAL MANUFACTURING
WITHOUT CONTROLS
WITH CONTROLS
PROPORTION, SEASONALLY ADJUSTED
.84
.82
.80
.78
.76
.74
.72
1
2
3
4
1
2
3
4
1
2
3
4
1980
1981
1982



RETAIL UNIT SALES OF NEW PASSENGER CARS - DOMESTIC

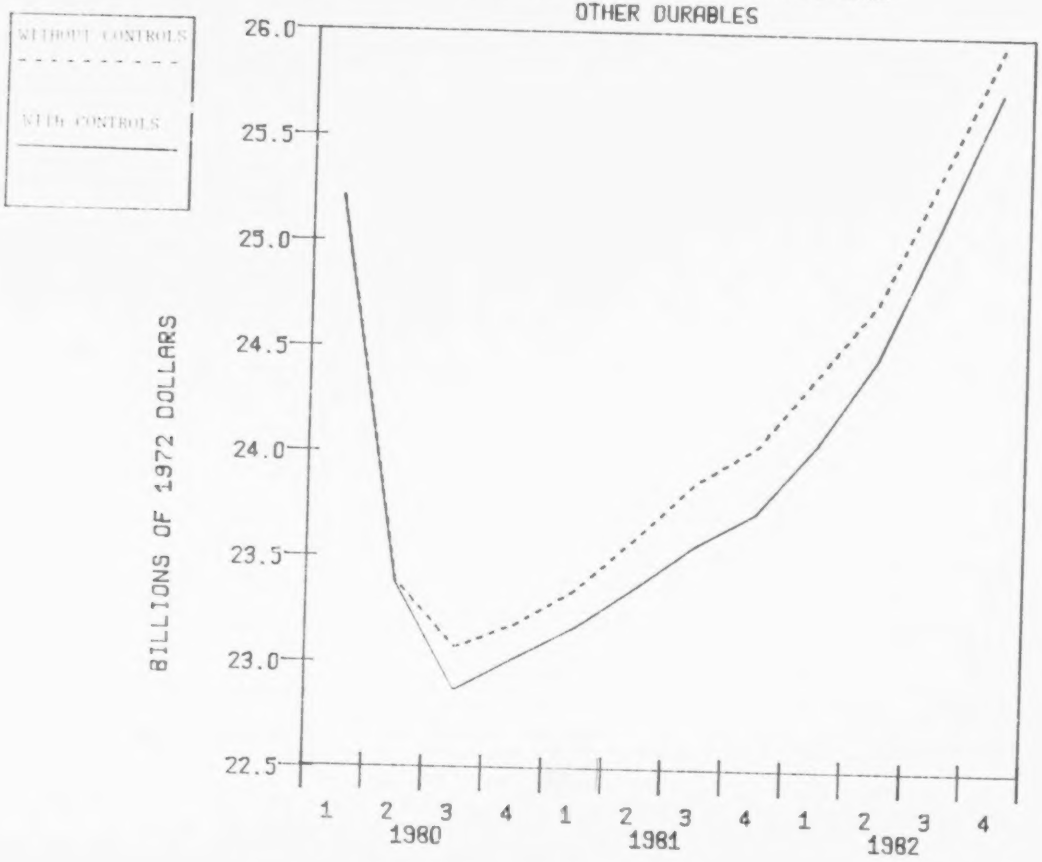


PERSONAL CONSUMPTION EXPENDITURES
OWNER OCCUPIED HOUSING



PERSONAL CONSUMPTION EXPENDITURES
FUEL OIL AND COAL

PERSONAL CONSUMPTION EXPENDITURES
OTHER DURABLES



Chairman ANNUNZIO. Thank you, Professor Meiselman. I gather from your statement that you are opposed to the legislation.

I welcome Congressman George Hansen to the subcommittee. He is not a member of the subcommittee, but of the full committee.

Mr. HANSEN. Thank you, Mr. Chairman.

May I inject at this point, on behalf of minority members of the subcommittee, we welcome the witnesses here today. We consider your testimony very important to consideration of this proposal, and we appreciate the sacrifice you made to be here on relatively short notice.

I want to assure you that the members of this subcommittee, and especially speaking for the minority, consider what you have to say very important, and I have heard several express the wish that they could be here today.

This hearing happened to fall on a Friday, and it is a year in which there are a lot of activities going on which conflict, and so it makes it very difficult. Mr. Paul said that he had made an effort to—when he found that there would be a problem of attendance—made an effort to change the date of the hearing, but this could not be worked out with the chairman, and so I want you to know that under the circumstances, that we will study your testimony.

Although I sit on the Domestic Monetary Policy Subcommittee, and I am the ranking member there, we have been going through this question very extensively, and we are very interested in what you have to say. We will all take an interest, and certainly I feel the testimony that has been given here concerning the Credit Control Act relates to an idea whose time is gone, and I hope we can get rid of it, because we don't need to be allocating shortages.

We need to be generating surplus and opportunity in this country; so I do appreciate the opportunity to listen to you this morning, and I thank the chairman for his indulgence.

Chairman ANNUNZIO. I thank my colleague, but I want to again make it clear to him that every witness that is appearing here this morning was selected and was asked by the minority, and the minority was extended every consideration.

Ron Paul asked that members of the administration, Mr. Wiedenbaum, be invited. He was invited to appear yesterday, and then he called saying he could not make it.

I know that my distinguished friend recognizes the problem we have with getting these committee rooms. It was not short notice. Three weeks ago all the witnesses were invited. It is not easy to get these rooms, and we have to proceed as we can.

I am grateful that we are all here, and I am here to listen very carefully to your testimony, and I am appreciative of the fact that you are all here this morning, but I have been in Congress 18 years, and I have yet to work 5 days a week. I have been working 7 days a week.

Mr. HANSEN. I would like to second that. The chairman and I came to Congress together, back in the early sixties, and I know the chairman to be a hard-working, dedicated Member of Congress, and we do appreciate the chairman's consideration for these hearings.

Chairman ANNUNZIO. Our next witness is Mr. Robert A. Mooney.

I have already granted permission to place your entire statement in the record, so you may proceed in your own manner.

I welcome you to the subcommittee. You represent a great organization.

STATEMENT OF ROBERT A. MOONEY, MANAGER OF CORPORATE ECONOMICS, J. C. PENNEY CO., INC., REPRESENTING THE NATIONAL RETAIL MERCHANTS ASSOCIATION AND THE AMERICAN RETAIL FEDERATION

Mr. MOONEY. Thank you.

Mr. Chairman, Congressman Hansen, I wish to thank you for the invitation to present my views here this morning on behalf of the National Retail Merchants Association and the American Retail Federation.

I have submitted a full written statement, which I would like to summarize here this morning.

My name is Robert A. Mooney. I am the manager of corporate economics for the J. C. Penney Co., Inc.

On behalf of the National Retail Merchants Association and the American Retail Federation, I urge the subcommittee not to support granting to the President the standby authority to control or restrict credit in our economy.

NRMA and ARF believe free market forces are a much better mechanism to control and allocate credit than compulsory credit controls. The experience with credit controls in 1980 clearly illustrates their ability to disrupt and distort economic activity. This experience also serves to show that the impact of credit controls cannot be confined to a select group of credit users.

Providing the President with permanent standby authority to institute credit controls will create enormous political pressure to make use of this authority. This is particularly true, given the new language in H.R. 6124, which states:

> Whenever the President determines that such action is necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession, the President may authorize the Board to regulate and control any or all extensions of credit.

The conclusion is implicit that credit controls can reduce unemployment and prevent or control inflation and recession. The President would appear derelict by failing to invoke some form of credit controls whenever these economic problems occurred. It is our view that credit controls not only will not solve these problems but rather will often make them worse.

In March 1980, the Credit Control Act of 1969 was invoked for the first time by President Carter. The perception existed that consumer credit usage was excessive and that this was causing inflation to accelerate. Credit to purchase homes, automobiles, and, in some instances, major household durables, was exempted from the controls.

The imposition of controls threw a then faltering economy into a sharp downward spiral. Real GNP fell at a seasonally adjusted annual rate of 9.9 percent in the second quarter of 1980. The unemployment rate in the second quarter rose to 7.3 percent from 6.2 percent in the first quarter. Prices, as measured by the GNP defla-

[illegible] rose at a 9.8-percent rate in the second quarter, up from 9.3 percent in the first quarter.

The housing and automobile industries were not protected by their exclusion from the credit controls. In the second quarter of 1980 Real investment in residential housing fell at a seasonally adjusted, annual rate of 60 percent; real consumer spending on new automobiles fell 82 percent; and real spending on household furnishings fell 23 percent.

These industries have not recovered to this day.

The controls were aimed largely at consumer revolving credit. General merchandise retail companies argued that this was not very equitable and that it made little sense, because consumer revolving credit is a fairly minor part of the overall credit market. The industry also pointed out that the burden of controls would fall most heavily on lower income individuals because of the limited credit alternatives available to them.

The credit controls imposed in 1980 actually had a much greater impact on credit for automobiles and housing than on consumer revolving credit. In the second quarter of 1980, net extensions of consumer revolving credit fell at a seasonally adjusted, annual rate of [illegible] percent. Credit extensions for automobiles fell 74 percent and for mobile homes 60 percent. Net extensions of residential mortgage credit fell at a seasonally adjusted, annual rate of 85 percent.

This serves to illustrate the inability to target credit controls selectively. Once imposed, credit controls will affect the flow of credit in many diverse ways.

The general merchandise retail industry also saw a sharp decline in credit sales and new credit applications. It took some time after the credit controls were ended in July 1980 for credit usage to return to normal levels. The imposition of controls left many consumers confused. Some were led to believe that the use of credit was unpatriotic.

The recession in 1980 was not caused by the imposition of credit controls. It would have occurred anyway. But the credit controls caused the decline in economic activity to be sharper and more disruptive than it otherwise would have been. By the end of 1980, interest rates had reached levels higher than those in March 1980, when the controls were imposed.

Credit controls do not expand the amount of credit available. All that they can possibly do is cause a reallocation of credit which, in most instances, will prove to be temporary. Credit sources and credit usage are very fluid. The term that is often used is "fungible." This is particularly true when we are talking about the larger, better financed business organizations and higher income individuals. These borrowers have a variety of methods of raising funds and because of their creditworthiness are actively sought by suppliers of credit. Credit controls will invariably cause an inequitable burden for underfinanced small businesses and lower income consumers.

[illegible] that credit controls will actually reduce the amount of credit available. The imposition of controls is aimed at removing [illegible] area of the economy which is deemed to be healthy [illegible] it to an area felt to be sick. There is no reason to believe that credit denied to one sector of the economy will then become available to another sector. This is not how credit works. The net result of credit controls could be a reduction in the total amount of credit available and the turning of a healthy sector into a sick one.

Trying to channel credit away from "nonproductive" users puts Government policymakers in the uncomfortable position of trying to play God. A free marketplace is much better able to allocate credit than Government officials.

The Federal Government is having enough trouble with its own financial situation. It would be a serious mistake to bring the heavy hand of Government into private credit decisions.

Part of H.R. 6124 addresses corporate acquisitions for cash. These are viewed as nonproductive uses of capital. It is hard to understand how all corporate acquisitions can be considered nonproductive. Many serve to save jobs, increase productivity and heighten competition. The Government seems to favor acquisitions of thrift organizations when there is a need to protect depositors. Shouldn't the shareholders and creditors of nonfinancial corporations be permitted to protect their financial positions?

It is a mistake to view credit used for corporate acquisitions as being lost from the marketplace. When corporations borrow money for acquisitions, or anything else, it does not sit idle. It will typically be invested in short-term financial instruments until it is used. When an acquisition takes place and stockholders receive cash, they will typically reinvest this money. The problems created in financial markets by acquisitions for cash are, at most, transitory and quite minimal.

High interest rates continue to plague our economy. Controls won't solve the problem. In fact, the threat of credit controls can have a very perverse impact on financial markets. If interest rates rise, the fear that controls will be imposed may actually strengthen loan demand as a hedge against controls.

In order to reduce interest rates we need sound fiscal and monetary policies which are aimed at noninflationary economic growth and will stimulate additional savings. We need to convince the financial markets that the deficit will be controlled and that there is no need to fear a sharp increase in the money supply. Credit controls create the illusion that we can dictate lower interest rates without sacrifice.

Thank you, Mr. Chairman.

Chairman ANNUNZIO. Thank you very much for your statement.

[Mr. Mooney's prepared statement, on behalf of the National Retail Merchants Association and the American Retail Federation, follows:]

PREPARED WRITTEN STATEMENT
OF
ROBERT A. MOONEY
MANAGER OF CORPORATE ECONOMICS
J.C. PENNEY COMPANY, INC.
REPRESENTING THE
NATIONAL RETAIL MERCHANTS ASSOCIATION
AND THE AMERICAN RETAIL FEDERATION

My name is Robert A. Mooney. I am Manager of Corporate Economics for the J.C. Penney Company, Inc. On behalf of the National Retail Merchants Association and the American Retail Federation, I urge the Subcommittee not to support granting to the President the stand-by authority to control or restrict credit in our economy.

By way of background, NRMA is the nation's largest trade association for the general merchandise retail industry. Its corporate members operate 40,000 department, chain and specialty stores across the country, with annual sales of approximately $177 billion, and nearly 3 million employees.

The ARF membership consists of 33 national retail trade associations, 50 state retail associations, the Greater Washington Board of Trade, as well as corporate members. Through its members, ARF represents more than a million retail establishments.

NRMA and ARF believe free market forces are a much better mechanism to control and allocate credit than compulsory credit controls. The experience with credit controls in 1980 clearly illustrates their ability to disrupt and distort economic activity. This experience also serves to show that the impact of credit controls can't be confined to a select group of credit users.

Providing the President with permanent stand-by authority to institute credit controls will create enormous political pressure to make use of this authority. This is particularly true given the new language in H.R. 6124 which states: "Whenever the President determines that such action is necessary or appropriate to reduce high levels of unemployment in any sector of the economy, or to prevent or control inflation or recession, the President may authorize the Board to regulate and control any or all extensions of credit."

The conclusion is implicit that credit controls can reduce unemployment and prevent or control inflation and recession. The President would appear derelict by failing to invoke some form of credit controls whenever these economic problems occurred. It is our view that credit controls not only will not solve these problems but rather, will often make them worse.

In March of 1980, the Credit Control Act of 1969 was invoked for the first time by President Carter. The perception existed that consumer credit usage was excessive and that this was causing inflation to accelerate. Credit to purchase homes, automobiles, and, in some instances, major household durables was exempted from the controls.

The imposition of controls threw a then faltering economy into a sharp downward spiral. Real GNP fell at a seasonally adjusted annual rate of 9.9 percent in the second quarter of 1980. The unemployment rate in the second quarter rose to 7.3 percent from 6.2 percent in the first quarter. Prices, as measured by the GNP deflator, rose at a 9.8 percent rate in the second quarter, up from 9.3 percent in the first quarter.

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o real investment in residential housing fell at a seasonally adjusted, annual rate of 60 percent;

o real consumer spending on new automobiles fell 82 percent; and

o real spending on household furnishings fell 23 percent.

These industries have not recovered to this day.

The controls were aimed largely at consumer revolving credit. General merchandise retail companies argued that this was not very equitable and that it made little sense, because consumer revolving credit is a fairly minor part of the total credit market. The industry also pointed out that the burden of controls [illegible] fall most heavily on lower income individuals because of the limited credit alternatives available to them.

The credit controls imposed in 1980 actually had a much greater impact on credit for automobiles and housing than on consumer revolving credit. In the second quarter of 1980 net extensions of consumer revolving credit fell at a seasonally-adjusted annual rate of 10 percent. Credit extensions for automobiles fell 74 percent and for mobile homes 68 percent. Net extensions of residential mortgage credit fell at a seasonally-adjusted annual rate of 85 percent.

This serves to illustrate the inability to target credit controls selectively. Once imposed, credit controls will affect the flow of credit in many diverse ways.

The general merchandise retail industry also saw a sharp decline in credit sales and new credit applications. It took some time after the credit controls were ended in July of 1980 for credit usage to return to normal levels. The imposition of controls left many consumers confused. Some were led to believe that the use of credit was unpatriotic.

The recession in 1980 wasn't caused by the imposition of credit controls. It would have occurred anyway. But the credit controls caused the decline in economic activity to be sharper and more disruptive than it otherwise would have been. [illegible] year of 1980, interest rates had reached levels higher than those in March of 1980 when the controls were imposed.

Credit controls do not expand the amount of credit available. All that they [illegible] cause a reallocation of credit which, in most instances, will prove [illegible]. Credit sources and credit usage are very fluid. The term that is [illegible]. This is particularly true when we are talking about the [illegible] organizations and higher income individuals. These [illegible] methods of raising money and because of their credit- [illegible] sources of credit. Credit controls will [illegible] cause an inordinate burden for underfinanced small businesses and lower [illegible] consumers.

It is likely that credit controls will actually reduce the amount of credit available. The imposition of controls is aimed at removing credit from one area of the economy which is deemed to be healthy and moving it to an area felt to be [illegible]. There is no reason to believe that credit denied to one sector of the economy will then become available to another sector. This is not how credit works. The net result of credit controls could be a reduction in the total amount of credit [illegible] and the turning of a healthy sector into a sick one.

Trying to channel credit away from "nonproductive" users puts government [illegible] in the uncomfortable position of trying to play God. A free market- [illegible] better able to allocate credit than government officials. The Federal [illegible] is having enough trouble with its own financial situation. It would be a [illegible] mistake to bring the heavy hand of government into private credit decisions.

[illegible] of H.R. 6124 addresses corporate acquisitions for cash. These are viewed [illegible] uses of capital. It is hard to understand how all corporate acqui- [illegible] be considered nonproductive. Many serve to save jobs, increase pro- [illegible] and heighten competition. The government seems to favor acquisitions of [illegible] organizations when there is a need to protect depositors. Shouldn't the [illegible] and creditors of nonfinancial corporations be permitted to protect their [illegible]?

[illegible] to view credit used for corporate acquisitions as being lost [illegible]. When corporations borrow money for acquisitions, or any- [illegible] it will typically be invested in short term [illegible] takes place and stock- [illegible] will [illegible] money. The problems created in financial markets by acquisitions for cash are, at most, transitory and quite minimal.

High interest rates continue to plague our economy. Controls won't solve this problem. In fact, the threat of credit controls can have a very perverse impact on financial markets. If interest rates rise the fear that controls will be imposed may actually strengthen loan demand to hedge against controls.

In order to reduce interest rates we need sound fiscal and monetary policies which are aimed at noninflationary economic growth and will stimulate additional savings. We need to convince the financial markets that the deficit will be controlled and that there is no need to fear a sharp increase in the money supply. Credit controls create the illusion that we can dictate lower interest rates without sacrifice.

In summary:

1. Credit controls are not an effective policy tool to prevent recession, reduce unemployment, or even lower inflation. They may be able to temporarily accomplish the latter but only at the cost of recession and high unemployment.

2. The experience with credit controls in 1980 should be a sobering lesson as to their failure as a policy tool.

3. Providing the President with stand-by authority will totally politicize the credit control issue.

I wish to thank the Subcommittee for extending this invitation and soliciting the views of the National Retail Merchants Association and the American Retail Federation on this very important issue.

Chairman ANNUNZIO. Our next witness is Mr. Robert Genetski. You may proceed in your own manner. Your entire statement will be made part of the record.

STATEMENT OF ROBERT J. GENETSKI, VICE PRESIDENT AND ECONOMIST, HARRIS TRUST & SAVINGS BANK, CHICAGO, ILL.

Mr. GENETSKI. Mr. Chairman, I am Robert Genetski, vice president and economist with the Harris Trust & Savings Bank in Chicago, and I am here to present the views of the American Bankers Association.

Chariman ANNUNZIO. Do you live in Chicago?

Mr. GENETSKI. Thirty miles west of the city of Chicago.

Chairman ANNUNZIO. We had an unusual situation the other day.

We had six witnesses before the subcommittee, and three lived in Chicago, and in asking the question, I discovered that all three lived in my own congressional district; so it is a small world.

Mr. GENETSKI. Well, I am here today to present the views of the American Bankers Association with regard to H.R. 6124, a bill to reinstitute and expand the Credit Control Act of 1969.

Mr. Chairman, ABA has consistently opposed attempts by the Government to allocate credit. We all want economic policies that will lead to lower interest rates and provide adequate credit to all sectors of the economy. However, we firmly believe that Government-mandated credit controls are not the way to achieve these goals; in fact, we believe the evidence clearly shows that credit controls do considerably more harm than good.

In the midst of the difficulties of bringing inflation under control, credit controls may seem to offer a quick-fix to restoring economic health. But credit controls do not promote stability. Moreover, credit controls are likely to sidetrack the necessary efforts toward monetary and fiscal restraint which will, in the long run, promote economic stability. The American Bankers Association strongly opposes credit controls as proposed in H.R. 6124 for the following reasons:

First, credit controls do not address the basic causes of inflation which are excessive expansion of the money supply, uncontrolled Government spending, and regulatory and other impediments to the free movement of resources in response to supply and demand forces.

Second, credit controls inevitably result in the channeling of funds into the uncontrolled intermediaries in the financial markets. Because credit is fungible, those who demand credit will find ways to obtain it and suppliers will provide it despite the best efforts of the regulators. In this regard, the ingenuity of the market in developing innovative credit techniques and instruments should not be underestimated. For example, attempts to control our balance of payments deficits by limiting capital outflows in the 1960's helped spur the development of the Eurodollar market. Attempts to assure low-cost mortgage funds through deposit interest rate ceilings have prompted the creation of new financial instruments such as money market funds to meet savers' demands for market-determined rates. These ceilings have also, I might add, put saving and loan associations in a very precarious situation when interest rates in the market rose much higher than the actual ceilings. It is futile for policymakers to try to anticipate market innovations and construct controls to prevent them.

Third, credit is most productively allocated in financial markets by interest rates. Credit controls attempt to allocate credit according to regulatory fiat without regard for market forces. The result is invariably a less efficient distribution of resources. Moreover, when credit is redirected to other channels in response to controls, less efficient intermediaries may assume a larger role. Commercial banks, for example, are efficient intermediaries in gathering funds and making the credit judgments involved in lending those funds to borrowers. Credit controls that result in a significantly greater volume of lending outside the banking system could entail a deterioration of credit standards and quality.

Fourth, the existence of standby credit controls leads to expectations by market participants that the controls will be invoked. These expectations, in turn, lead to protective actions on the part of lenders and borrowers that can accelerate actual or potential credit demands, thus actually exacerbating the problems credit controls were designed to alleviate.

Fifth, because of the difficulty of influencing various segments of the money and capital markets, credit controls would likely be concentrated on bank credit. Not only would that result in credit moving into other channels, as we have argued previously, but in our opinion, bank credit is not an appropriate target of monetary policy. The monetary base and certain measures of the money supply are more appropriate targets because they relate to total economic activity in a more logical and statistically reliable way. Moreover, controlling the monetary base, which consists of reserves of the Federal Reserve banks and currency held by banks and by the public, will exert a measure of control over bank credit.

Sixth, even the most competent bureaucracy cannot and should not decide which uses of credit are "productive and necessary" and which are "nonproductive." Corporate acquisitions are singled out by H.R. 6124 as an example of "nonproductive." However, mergers and acquisitions are often good business practice, adding to the stability and productivity of some industries and thereby enhancing employment prospects in those industries.

A main push for credit controls comes about because of faulty economic analysis. There is an error in assuming that just because we prevent $1 billion in loans to acquire a particular company, that there will be an additional $1 billion available for new houses, new autos, or new plants and equipment. When a company borrows funds for a merger, it transfers the assets involved so that the funds go from one owner to the next. All this means is that the seller of the assets now has the funds with which they can make loans for new houses, et cetera. This is a very important process, because it involves increasing the liquidity of particular investments, thereby making them more attractive and thereby stimulating more savings than we otherwise would have had.

Perhaps the most persuasive argument, however, against credit controls is a review of their impact on the economy when they were invoked March 14, 1980. The impact of the credit control pro-

[illegible] on the economy at that time was substantial. Financial markets, already jittery, responded to the added uncertainties of the [illegible] controls with a dramatic drop in stock and bond prices. Housing starts and retail sales, which were already trending down, took a nosedive. Consumers, responding to the controls on credit cards, virtually stopped buying; the decline in consumer installment credit in May and June was the largest on record. Real GNP declined over 9 percent in the second quarter of 1980, its worst showing since the 1930's. The consumer price index, which was also beginning to decline during the first quarter of 1980, was temporarily depressed further but bounded back as soon as the controls were lifted. Short-term interest rates also fell significantly, but soared again after controls were lifted in July.

It is clear that the imposition of credit controls in March 1980 exacerbated an already declining economy, pushing it into an unnecessarily violent contraction. As mute testimony that the credit control program was having an unexpectedly harsh impact on the economy, the Fed, on May 22—just 5 weeks after implementation—began dismantling the controls. By July 3, the Fed announced plans for the complete removal of the remaining controls. Moreover, the controls failed to produce the intended benefits—inflation and interest rates both rebounded to precontrol levels during the second half of 1980.

The damage done to the economy by the imposition of credit controls is difficult to quantify. However, Data Resources, Inc., has made estimates of some of the social costs stemming from the control program as follows: GNP loss, $23 billion; employment loss, 200,000 man-years; Federal tax loss, $7 billion; new car sales loss—domestic, 500,000 units; loss in total consumption, $19 billion; and loss in housing starts, 50,000 units.

In conclusion, we believe that the 1980 experience with credit controls confirms our contention that the economy is best served by freely competitive markets, where each participant is free to make his own choice in the allocation of his resources. No bureaucracy, no matter how well intentioned, should be empowered to substitute their decisions for the millions of private economic decisions made daily by the American public. For these reasons, our association believes that resorting to credit controls would be unwise. Not only are credit controls ineffective, but they distort the flow of credit and allocate it inefficiently.

In the end, it would make a bad economic situation even worse.

[illegible] very.

[Mr. [illegible]'s prepared statement, on behalf of the American Bankers Association, follows:]

STATEMENT

OF

ROBERT J. GENETSKI

on behalf of

THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and members of the Subcommittee, I am Robert J. Genetski, Vice President and Economist of the Harris Trust and Savings Bank, Chicago. I am here today to present the views of the American Bankers Association. Our Association's membership includes over 90 percent of the more than 14,500 full service banks in the United States. While our members range in size from the very smallest to the very largest banks, approximately 90% of them have assets of less than $100 million.

We appreciate the opportunity to testify on H.R. 6124, a bill to reinstitute and expand the Credit Control Act of 1969 (P.L. 91-151) which expired on June 30, 1982. Under P.L. 91-151, the President was empowered to invoke credit controls during periods of "...inflation generated by the extension of credit in excessive volume...". H.R. 6124 proposes to expand the conditions under which the President could impose credit controls to include periods of high unemployment and recession as well as inflation. Moreover, H.R. 6124 proposes to increase the extent of control given to the Federal Reserve Board under the Act to include allocation of credit away from "nonproductive purposes" toward "productive purposes".

Mr. Chairman, ABA has consistently opposed attempts by the government to allocate credit. We all want economic policies that will lead to lower interest rates and provide adequate credit to all sectors of the economy. However, we firmly believe that government mandated credit controls are not the way to achieve these goals; in fact, we believe the evidence clearly shows that credit controls do considerably more harm than good.

The problems that H.R. 6124 seeks to correct stem from the high and volatile rates of inflation which have plagued our economy during the past five years. Inflation has been primarily responsible for the unprecedented level of interest rates, and the resulting distortions to the traditional distribution of available credit. The inflation this country has been experiencing is the result of uncontrolled government spending supported by overly liberal monetary growth. Changing these long standing policies and winding down the deeply entrenched forces of inflation is proving to be difficult and painful, but slowly we are making significant progress in reducing the rate of inflation.

In the midst of the difficulties of bringing inflation under control, credit controls may seem to offer a quick-fix to restoring economic health. But credit controls do not promote stability. Moreover, credit controls are likely to sidetrack the necessary efforts toward monetary and fiscal restraint which will, in the long run, promote economic stability. The American Bankers Association strongly opposes credit controls as proposed in H.R. [illegible] for the following reasons:

1. Credit controls do not address the basic causes of inflation which are excessive expansion of the money supply, uncontrolled government spending, and regulatory and other impediments to the free movement of resources in response to supply and demand forces. In retrospect, I think it is fair to say that monetary and fiscal policies have been too expansive for too long. We have paid the price in terms of a stubbornly high and [illegible] rate of inflation that will take a long time to bring under control.

2. Credit controls inevitably result in the channeling of funds into the uncontrolled intermediaries in the financial markets. Because credit is fungible, those who demand credit will find ways to obtain it and suppliers will provide it despite the best efforts of the regulators. In this regard, the ingenuity of the market in developing innovative credit techniques and instruments should not be underestimnated. For example, attempts to control

balance of payments deficits by limiting capital outflows in the 1960s helped spur the development of the Eurodollar market. Attempts to assure low-cost mortgage funds through deposit interest rate ceilings have prompted the creation of new financial instruments such as money market funds to meet public demands for market-determined rates. It is futile for policymakers to try to anticipate market innovations and construct controls to prevent them. The innovations will inevitably frustrate the controls, not because market participants are malicious but because they deal in a fungible commodity that responds to supply and demand forces.

(3) Credit is most productively allocated in financial markets by market rates. Credit controls attempt to allocate credit according to social priorities without regard for market forces; the result is invariably a less efficient allocation of resources. Moreover, when credit is channeled to other markets in response to controls, less efficient intermediaries may assume a larger role. Commercial banks for example, are efficient intermediaries in gathering funds and making the credit judgments involved in lending those funds to borrowers. Credit controls that result in a significantly greater volume of lending outside the banking system, through the commercial paper market for example, could entail a deterioration of credit standards and quality.

(4) The existence of standby credit controls leads to expectations by market participants that the controls will be invoked. These expectations, in turn, lead to protective actions on the part of lenders and borrowers that accelerate the growth of potential credit demands, thus actually exacerbating the problems credit controls were designed to alleviate. For example, fear of credit controls may induce business firms to arrange for larger lines of credit from their bank rather than relying on internal

[illegible] credit.

[illegible]. Because of the difficulty of influencing various segments of [illegible] and capital markets, credit controls would likely be concentrated [illegible] bank credit. Not only would that result in credit moving into other [illegible], as we have argued previously, but in our opinion, bank credit is [illegible] appropriate target of monetary policy. The monetary base and certain [illegible] of the money supply are more appropriate targets because they [illegible] total economic activity in a more logical and statistically [illegible] way. Moreover, controlling the monetary base, which consists of [illegible] of the Federal Reserve banks and currency held by banks and by the [illegible] exert a measure of control over bank credit.

[illegible] even the most competent bureaucracy can not and should not decide [illegible] of credit are "productive and necessary" and which are [illegible]". Corporate acquisitions are singled out by H.R. 6124 as an example of "nonproductive". However, mergers and acquisitions are often [illegible] practical means to the stability and productivity of some [illegible] thereby enhancing employment prospects in those industries.

[illegible] the most eloquent argument against credit controls is a review [illegible] impact on the economy when invoked on March 14, 1980. Before [illegible] were invoked, inflation had been rising consistantly since [illegible] interest rates experienced a corresponding upward trend. By 1979, [illegible] of increasing inflation and rising interest rates was [illegible] real growth of the economy. But inflation continued, [illegible] at an annual rate of almost 13% in 1979.

[illegible], 1979, the Fed took steps to improve control over the growth [illegible] by changing their operating procedure. The impact on [illegible]. Money supply growth slowed substantially, interest rates rose, and total bank loans grew slowly. While it is clear that the economy was beginning to respond to the new monetary policy, credit controls were invoked by the President on March 14, 1980.

Essentially, the credit control program designed by the fed was intended to reduce the overall growth in bank loans, and was particularly aimed at curtailing the growth of unsecured consumer credit, financing of corporate mergers, and speculation in commodity markets. Lenders were encouraged to maintain credit flows to agriculture, home finance, and small business. Auto financing was exempt from the credit restraints. Growth of money market funds was subjected to a special deposit requirement of 15% on increases in total assets.

The impact of the credit control program on the economy was substantial. Financial markets, already jittery, responded to the added uncertainties of the credit controls with a dramatic drop in stock and bond prices. Housing starts and retail sales, which were already trending down, took a nose dive. Consumers, responding to the controls on credit cards, virtually stopped buying; the decline in consumer installment credit in May and June was the largest on record. Real GNP declined over 9% in the second quarter of 1980, its worst showing since the 1930's. The consumer price index, which was also beginning to decline during the first quarter of 1980, was temporarily depressed further but bounced back as soon as the controls were lifted. Short term interest rates also fell significantly, but soared again after controls were lifted in July.

It is clear that the imposition of credit controls in March 1980 exacerbated an already declining economy, pushing it into an unnecessarily violent contraction. As mute testimony that the credit control program was having an unexpectedly harsh impact on the economy, the Fed on May 22 —

just 5 weeks after implementation -- began dismantling the controls. By July 3, the Fed announced plans for the complete removal of the remaining controls. Moreover, the controls failed to produce the intended benefits — inflation and interest rates both rebounded to pre-control levels during the second half of 1980.

The damage done to the economy by the imposition of credit controls is difficult to quantify. However, Data Resources, Inc. has made estimates of some of the social costs stemming from the control program as follows

GNP Loss	$23 billion
Employment loss	300,000 man years
Federal Tax loss	$7 billion
New Car Sales loss (domestic)	500,000 units
Loss in total consumption	$19 billion
Loss in housing starts	50,000 units

In conclusion, we believe that the 1980 experience with credit controls confirms our contention that the eccnomy is best served by freely competitive markets, where each participant is free to make his own choice in the allocation of his resources. No bureaucracy, no matter how well intentioned, should be empowered to sustitute their decisions for the millions of private economic decisions made daily by the American public.

For these reasons, our Association believes that resorting to credit controls would be unwise. Not only are credit controls ineffective, but they distort the flow of credit and allocate it inefficiently. Economic stability can only be achieved through responsible monetary and fiscal policies.

Conceivably one could agree with these arguments against credit controls and still favor keeping the Credit Control Act on the books as a policy tool to be held in reserve for use in some undefined emergency. We believe that legislation should not be justified on the basis that it might some day come in handy, especially when logical analysis and experience [illegible] testimony.

[illegible] standby authority has on the [illegible] past [illegible]. As discussed earlier in the [illegible] to anticipate the [illegible] actions they often take will [illegible] designed to alleviate. For [illegible] at the present imposition of [illegible]. ABA received numerous calls from [illegible] were drawing on [illegible] borrowed money on the bank [illegible] to the [illegible] should the [illegible] authority for Congress to [illegible]

Chairman ANNUNZIO. Thank you very much.

Our next witness is Mr. Thomas Durkin.

STATEMENT OF THOMAS A. DURKIN, DIRECTOR OF RESEARCH AND EDUCATION, NATIONAL CONSUMER FINANCE ASSOCIATION

Mr. DURKIN. My name is Thomas A. Durkin. I am director of research and education of the National Consumer Finance Association and adjunct senior research associate in finance at the Pennsylvania State University.

I welcome this opportunity to comment today on NCFA's views concerning H.R. 6121, a bill to extend the Credit Control Act of 1969.

NCFA shares the subcommittee's concern, and, I think, the concern of all Americans, that economic policies of the Government be directed toward encouraging long-term, noninflationary economic growth with full employment. We question, however, whether controls on consumer credit—even on a standby basis—are appropriate in promoting this important objective.

First of all, at the philosophical level we question whether it is the proper role of Government in a free society to tell individuals they cannot engage in those activities, when they freely choose to engage in those activities, when they regard those activities as beneficial to themselves, when the activities are harmful to no one, and when, in the case of consumer credit use, the activities are supportive of major American industries employing millions of people.

It is a widespread myth, often perpetuated by those whose personal resources enable them to provide for their own needs and wants on a purely cash basis, that individual consumers are worse off when they enter into credit agreements.

This, of course, is not the case. Consumers enter into credit agreements by free choice. They make such choices because they perceive the benefits to themselves in the form of returns on the assets and education they purchase to be worth the costs they must, in turn, pay savers to borrow their resources. Limiting consumers' opportunities to make their own choices in this area by Government fiat does them a disservice.

Second, based on economic principles, we question whether this bill will promote any of its stated purposes. In the one instance when Presidential powers under the Credit Control Act of 1969 were exercised, consumer credit was a major target of the resulting controls. But, attempts by Government to control the consumer credit marketplace by decree are vulnerable to a long list of economic criticisms.

A first important economic criticism must be directed at the basic misconception supporting consumer credit controls in the first place—the erroneous view that consumers' credit use is nonproductive.

Consumers do not borrow to waste the resources; rather, as already mentioned, they borrow to make investments in productive assets. Consumers' investments in houses, automobiles, appliances, education, and medical care financed by credit are capital assets that provide a flow of returns over time in the form of valuable consumer services.

In this sense, consumer capital is exactly analogous to business capital, like factories, machines, and equipment, which provide investment returns over time to business.

By investing in capital goods, consumers, like businesses, can raise the total returns available to them over time. It does not seem reasonable that Congress would want to interfere with such borrowing for productive purposes.

A second economic criticism is directed at another fundamental premise of this bill, namely, that Federal bureaucrats can make better choices about resource allocation than a competitive marketplace governed by citizens' free choices. At present, in sharp contrast to the world's planned economies, Americans are free to choose the amount of their savings, to whom they lend, and from whom and for what they borrow.

In this environment the forces of competition have provided both a wide variety of savings outlets and credit sources. Why should we believe that the bureaucratic mill will provide better answers on resource allocation than the public's wants and needs?

Who, after all, is to decide what is productive and what should be controlled? Even apart from the issue of freedom of choice, which is the honored birthright of Americans, why should we assume that government officials with all their own biases can make better economic choices for citizens than the citizens can make for themselves?

A third economic criticism is that targeting consumer credit for control misplaces the blame for current difficulties in our Nation's capital markets. In sharp contrast to performance of their Federal Government, consumers' use of credit has been very restrained in the current business cycle. Consumer installment credit over the past 2 years has grown at a compound annual rate of only 3 percent. In deflated dollars consumer credit growth has been negative. Consumers' installment credit debt burden has been lower as well; the ratio of installment credit debt repayments to disposable personal income peaked in 1978, well before the 1980 episode with credit controls, and has been declining ever since.

These facts, readily available from Federal agency data, contradict the apparently widespread view that consumer credit growth has recently been explosive. This is in sharp contrast to the Federal debt picture. Gross public debt of the Treasury and the Federal and federally sponsored credit agencies exceeded $1,200 billion at yearend 1981 and had grown 25 percent in the prior 2 years alone. Projected mammoth Federal deficits in fiscal 1983 and beyond promise a continuation of tight capital markets and offer a clear picture of where Congress should direct controlling attention.

A fourth economic criticism must be leveled at the bureaucratic machinery necessary to monitor and administer any system of consumer credit controls. A few years ago, the Commission on Federal Paperwork estimated that creditors received 215 million credit applications in 1975, a figure that would probably be somewhat higher in more recent years.

How can such a monstrous total of separate transactions be effectively controlled without massive costly interventionism? Even if credit transactions are divided into controlled and noncontrolled categories as in 1980, who can really say where the money flows so it can be controlled?

Imagine, for example, an individual who has $15,000 and decides to buy a $7,500 car and a $7,500 boat. If there were no controls on consumer credit, this individual conceivably might pay cash for the car and use credit to buy the boat. If, however, boat credit were controlled and automobile credit uncontrolled, the individual would turn around and pay cash for the boat and would use credit to buy the car. What, then, would be the benefit of controls?

Credit of $7,500 would still be generated and a car and a boat would still be purchased. Nevertheless, there would still be costs to society in monitoring and enforcing bureaucratic rules about unproductive boat credit. Since the controls, in this case, would be redundant, their costs would be a dead-weight loss to society.

A fifth economic criticism is that in the event that consumer credit controls were effective in impacting consumer credit in any way, the impact would be selective on both consumers and industries. Studies by the Federal Reserve System, notably the "1977 Survey of Consumer Credit," the most recent evidence available—suggest that consumer credit use tends to be concentrated among particular population segments.

Importantly, consumer credit is more likely to be used, not surprisingly, by those in the family formation years where the family head's age is 25 to 45 years. Thus, to the extent that consumer credit controls do have an impact, the effect will be greatest on those trying to start and maintain new households.

With respect to industries, if controls have an impact, the effect should be on credit-sensitive industries such as housing, automobiles, and the appliance and recreational industries. These industries, of course, employ millions of Americans. While, presumably, consumer credit controls would intend selectivity, is selective devastation of industries employing millions of Americans ever likely to be good public policy?

In sum, for a long list of reasons, NCFA must recommend against passage of H.R. 6124, extending the Credit Control Act. I am pleased to have this opportunity to present NCFA's views on this matter, as well as to have the chance of answering your questions.

[Mr. Durkin's prepared statement, on behalf of the National Consumer Finance Association, follows:]

Statement of

Thomas A. Durkin

Director of Research and Education

National Consumer Finance Association

My name is Thomas A. Durkin. I am Director of Research and Education of the National Consumer Finance Association (NCFA)[1] and Adjunct Senior Research Associate in Finance at the Pennsylvania State University. I welcome this opportunity to comment today on NCFA's views concerning HR 6124, a bill to extend the Credit Control Act of 1969.

NCFA shares the Subcommittee's concern - and, I think, the concern of all Americans - that economic policies of the government be directed toward encouraging long-term, non-inflationary economic growth with full employment. We question, however, whether controls on consumer credit - even on a standby basis - are appropriate for promoting this important objective.

First of all at the philosophical level, we question whether it is the proper role of government in a free society to tell individuals they cannot engage in certain activities when they freely choose to engage in those activities, when they regard those activities as beneficial to themselves, when the activities are harmful to no one, and when, in the case of consumer credit use, the activities are supportive of major American industries employing millions of people. It is a widespread myth, often perpetuated by those whose personal resources enable them to provide for their own needs and wants on a purely cash basis, that individual consumers are worse off when they enter into credit agreements. This, of course, is not the case. Consumers enter into credit agreements by free choice. They make such choices because they perceive the benefits to themselves in the form of returns on assets and education they purchase to be worth the costs they must, in turn, pay savers to borrow their resources. Limiting consumers' opportunities to make their own choices in this area by government fiat does them a disservice.

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[1] Organized in 1916, NCFA is the national trade association of companies engaged in the consumer credit business. NCFA represents more than 400 companies operating more than 16,000 offices serving the public throughout the country. The membership of NCFA is highly diversified ranging from single, small loan offices to substantial nationwide financial services organizations engaged in unsecured direct lending, second mortgage lending and the financing of the sale of durable goods. The consumer finance industry accounts for more than one-fourth of all consumer credit outstanding, or approximately $97 billion of the $329 plus billion outstanding.

Second, based on economic principles we question whether this bill will promote any of its stated purposes. In the one instance when Presidential powers under the Credit Control Act of 1969 were exercised, consumer credit was a major target of the resulting controls. But, attempts by government to control the consumer credit marketplace by decree are vulnerable to a long list of economic criticisms.

A first important economic criticism must be directed at the basic misconception supporting consumer credit controls in the first place - the erroneous view that consumers' credit use is nonproductive. Consumers do not borrow to waste the resources, rather, as already mentioned, they borrow to make investments in productive assets. Consumers' investments in houses, automobiles, appliances, education, and medical care financed by credit are capital assets that provide a flow of returns over time in the form of valuable consumer services. In this sense consumer capital is exactly analogous to business capital like factories, machines, and equipment which provide investment returns over time to business. By investing in capital goods consumers - like businesses - can raise the total returns available to them over time. It does not seem reasonable that Congress would want to interfere with such borrowing for productive purposes.

A second economic criticism is directed at another fundamental premise of this bill - namely, that Federal bureaucrats can make better choices about resource allocation than a competitive marketplace governed by citizens' free choices. At present, in sharp contrast to the world's planned economies, Americans are free to choose the amount of their savings, to whom they lend and from whom and for what they borrow. In this environment the forces of competition have provided both a wide variety of savings outlets and credit sources. Why should we believe that the bureaucratic mill will provide better answers on resource allocation than the public's wants and needs? Who, after all, is to decide what is "productive" and what should be controlled? Even apart from the issue of freedom of choice, which is the honored birthright of Americans, why should we assume that government officials with all their own biases can make better economic choices for citizens than the citizens can make for themselves?

A third economic criticism is that targeting consumer credit for control misplaces the blame for current difficulties in our nation's capital markets. In sharp contrast to performance of their Federal government, consumers' use of credit has been very restrained in the current business cycle. Consumer installment credit over the past two years has grown at a compound annual rate of only 3 percent. In deflated dollars consumer credit growth has been negative. Consumers' installment credit debt burden has been lower as well; the ratio of installment credit debt repayments to disposable personal income peaked in 1978, well before the 1980 episode with credit controls, and has been declining ever since. These facts, readily available from Federal agency data, contradict the apparently widespread view that consumer credit growth has recently been explosive. This is in sharp contrast to the Federal debt picture. Gross public debt of the Treasury and the Federal and Federally-sponsored credit agencies exceeded $1,200 billion at year end 1981 and had grown 25 percent in the prior two years alone. Projected mammoth Federal deficits in fiscal 1983 and beyond promise a continuation of tight capital markets and offer a clear picture of where Congress should direct controlling attention.

A fourth economic criticism must be levelled at the bureaucratic machinery necessary to monitor and administer any system of consumer credit controls. A few years ago the Commission on Federal Paperwork estimated that creditors received 215 million credit applications in 1975, a figure that would probably be somewhat higher in more recent years. How can such a monstrous total of separate transations be effectively controlled without massive costly interventionism? Even if credit transactions are divided into controlled and non-controlled categories as in 1980, who can really say where the money flows so it can be controlled? Imagine, for example, an individual who has $15,000 dollars and decides to buy a $7,500 car and a $7,500 boat. If there were no controls on consumer credit, this individual conceivably might pay cash for the car and use credit to buy the boat. If, however, boat credit were controlled and automobile credit uncontrolled, the individual would turn around and pay cash for the boat and would use credit to buy the car. What, then, would be the "benefit" of controls? Credit of $7,500 would still be generated and a car and a boat would still be purchased. Nevertheless, there would still be costs to society in monitoring and enforcing bureaucratic rules about "unproductive" boat credit. Since the controls, in this case, would be redundant, their costs would be a dead-weight loss to society.

A fifth economic criticism is that in the event that consumer credit controls were effective in impacting consumer credit in any way, the impact would be selective on both consumers and industries. Studies by the Federal Reserve System - notably the 1977 Survey of Consumer Credit, the most recent evidence available - suggest that consumer credit use tends to be concentrated among particular population segments. Importantly, consumer credit is more likely to be used, not surprisingly, by those in the family formation years where the family head's age is 25-45. Thus, to the extent that consumer credit controls do have an impact, the effect will be greatest on those trying to start and maintain new households. With respect to industries, if controls have an impact, the effect should be on credit-sensitive industries such as housing, automobiles, and the appliance and recreational industries. These industries, of course, employ millions of Americans. While, presumably, consumer credit controls would intend selectivity, is selective devastation of industries employing millions of Americans ever likely to be good public policy?

In sum, for a long list of reasons, NCFA must recommend against passage of HR 6124 extending the Credit Control Act. I am pleased to have this opportunity to present NCFA's views on this matter, as well as to have the chance of answering your questions.

Chairman ANNUNZIO. Thank you, Mr. Durkin.

Our next witness is Drew Tidwell.

Mr. TIDWELL. Thank you, Mr. Chairman.

Chairman ANNUNZIO. Is Ms. Spillman going to testify?

Mr. TIDWELL. Yes, she will be presenting the majority of the testimony.

STATEMENTS OF DREW V. TIDWELL, GENERAL COUNSEL AND SECRETARY, CONSUMER BANKERS ASSOCIATION, AND NANCY Z. SPILLMAN, CHAIR, BUSINESS ADMINISTRATION DEPARTMENT, AND PROFESSOR OF ECONOMICS AT L.A. TRADE-TECHNICAL COLLEGE AND A MEMBER OF THE CALIFORNIA RETAIL CREDIT ADVISORY COMMITTEE

STATEMENT OF DREW V. TIDWELL

Mr. TIDWELL. I am Drew Tidwell, general counsel and secretary of the Consumer Bankers Association, and, on behalf of the Consumer Bankers Association, I am appearing with Nancy Z. Spillman, chair, business administration department and professor of economics at L.A. Trade-Technical College, and a member of the California Retail Credit Advisory Committee appointed by Gov. Jerry Brown.

Mr. Chairman, I will ask Professor Spillman to summarize her views as reflected in the written testimony.

STATEMENT OF NANCY Z. SPILLMAN

Ms. SPILLMAN. Thank you, Mr. Chairman, and Mr. Tidwell.

I welcome this opportunity to discuss the proposal to reenact the Credit Control Act of 1969. My advice is simply don't do it. There is no reason to keep on the books a law which, if implemented, would make it difficult for low- and moderate-income families to improve their living standards. That, after all, is the inevitable result of any controls over the free flow of credit.

The Nation's experience in mid-1980 under the Credit Control Act of 1969—the shocks and uncertainties it caused—argue strongly against its continuation. The second quarter 1980 decline in outstanding consumer credit amounted to almost $9 billion—the largest drop, in percentage as well as dollar terms, since World War II. Indeed, the restrictive actions of March 1980 transformed a fragile economic situation into a sharp decline, and we are still suffering the consequences.

In part due to uncertainties in the nature, scope, and consequences of the program, it substantially reduced credit availability. Later studies indicated that efforts to "carve out" special areas in dire need of access to credit markets—such as automobile sales, small business, and housing—failed, since creditors and borrowers alike were shocked into an across-the-board cutback in credit.

The Credit Control Act of 1969 gave the Federal Reserve more far-reaching authority than Congress ever before had granted, even during World War II. As one congressional critic noted at the time, the Fed could keep a patient from going to the doctor unless he paid cash. As former Fed Chairman Arthur Burns said, the act put "dictatorial power in the hands of the Federal Reserve, power that no Government agency should have." It is indeed strange that any

Congressman would support such a grant of unrestrained power to the Fed, when so many Members of this body are trying to limit the central bank's powers.

Credit controls can come in many forms. They can be limits on particular classes of loans, such as loans to certain industries or for certain purposes—or they can be limits on the terms of loans and deposits, such as the size of the downpayment or the interest rate charged on loans or paid on deposits. In all respects, controls are counterproductive.

Restricting loans to any one category is next to impossible, because money is so fungible. For instance, if a firm wants to buy a "nonproductive" company yacht, it can take out a loan for carrying inventories and thus free other funds for the yacht. Indeed, putting up barriers against the flow of credit is unlikely to do anything to increase productivity.

But putting up barriers costs the Government—and taxpayers—something in the form of bureaucratic redtape, and getting around those barriers costs consumers and businesses even more.

From the more visible costs of setting up and complying with a complex regulatory mechanism to the less visible costs of the disruptions and uncertainty that flow from altering market allocations of credit, controls will inevitably create greater systemic costs. Credit controls clearly raise the price of credit-related transactions and thereby aggravate inflation.

Similar problems arise from trying to use credit controls to moderate inflation by restricting demand for goods and services. Interest rate ceilings or other restrictions on small consumer loans, for example, fail to insure lower rates or regulate consumer demand.

When the market rate for such loans rises above the legal ceiling, they become extinct, because creditors don't want to make unprofitable loans. Banks have available a wide array of lending opportunities so that they can adjust their asset and liability portfolios in response to ceilings placed on consumer loan rates. Banks have available a wide array of lending opportunities, so that they can adjust their asset and liability portfolios in response to ceilings placed on consumer-loan rates. Creditors don't sit on their money; they invest in those markets where ceilings do not exist.

Rate ceilings also induce creditors to tighten their nonprice terms in order to reduce loan volume and to lower costs. To ration the existing supply of credit, institutions will tighten credit standards, allocate loans to existing customers, and limit maximum loan sizes. Also, as a means of reducing costs—especially loan losses and administrative expenses—institutions will allocate available credit to their most creditworthy, low-risk borrowers.

Rate ceilings thus may simply guarantee availability of credit to the "best" customers. Others will be left without credit, so lower income Americans and small businesses are always the first victims of credit controls.

Credit controls, of course, are unnecessary in periods of recession, such as today. In fact, the imposition of controls or even the discussion of their possible use causes an even further reduction in economic activity, thus worsening the recession and causing businesses to raise their prices in anticipation of controls in order that they not get caught with their prices down. Further, they are unnecessary in periods of inflation.

The best way to fight inflation—the least expensive and most enduring—is with well-designed monetary and fiscal policies. Policies of that type, when properly applied, always help to bring stability to the economy—unlike the disruptive credit controls of mid-1980.

I would suggest two examples of Government intervention that demonstrate the problem with the use of nonmarket mechanisms. The first involves attempts to replace the free market with Government restrictions on the amount of interest being paid by financial institutions, through regulation Q. The market found ways to avoid these limitations and money market mutual funds now hold more than $200 billion. This price control cost small savers $25 billion in 1981 alone.

A second example is provided by price controls on money in the form of State usury laws. Usury ceilings have caused severe distortions and inefficiencies, including causing lenders to shift funds to lending areas not subject to usury ceilings, and denying credit to many who these controls are said to help, like small businesses who cannot afford to carry their receivables due to these ceilings.

I also do not believe in attempting to segment the credit market that it is possible or fair to brand any one type of credit "nonproductive." Although markets work imperfectly at times, even if one were to accept the premise that "nonproductive" credit occurs, it is critical to weigh the damage caused by that "nonproductive" credit against the costs imposed by controls. The damage to the credit system and the economy resulting from Government interference would be far more destructive than any relatively minor nonproductive deviations that the market might permit.

The language proposed in H.R. 6124 provides an excellent illustration of the complexities involved in attempting to regulate any portion of the credit market. The legislation would permit the President to invoke credit controls at virtually any time, thereby putting the matter totally within unbridled Presidential discretion.

Once invoked, the Federal Reserve Board has virtually limitless powers to shape the credit market. The Board could conclude that Americans spend too much money on automobiles or houses, declare these to be "nonproductive" purposes, and thus outlaw the use of credit for these purposes. To delegate such authority to a 7-member board whose members serve a 14-year term effectively beyond political control is simply beyond any reasonable or appropriate level of delegation.

In conclusion, Mr. Chairman, I share your concerns about the current state of the economy and the level of interest rates. While some may argue that credit controls would provide an effective and painless "quick fix", we sincerely believe that further Government intervention in the market would not be effective, painless, or costless.

The problems are complex and many years in the making. They simply do not lend themselves to simple, quick solutions, despite the superficial appeal that those solutions might present. The single solution, as frustrating, painful, and deliberate as it may be, is to devise a steady strategy combining both fiscal and monetary restraint within a market economy that is permitted to operate with a minimum of Government involvement.

Thank you for providing us with this opportunity to testify.

[Mr. Tidwell's and Ms. Spillman's prepared statement, on behalf of the Consumer Bankers Association, and an article from the Journal of Retail Banking of June 1980, "Consumer Credit Controls: Risks and Lessons," follow:]

TESTIMONY OF THE CONSUMER BANKERS ASSOCIATION BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS AND COINAGE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS UNITED STATES HOUSE OF REPRESENTATIVES ON THE PROPOSED REENACTMENT OF THE CREDIT CONTROL ACT

Mr. Chairman,

I am Drew Tidwell, General Counsel and Secretary of the Consumer Bankers Association and I am appearing together with Nancy Z. Spillman, Director, Center for Economic Education and Professor of Economics at L.A. Trade Technical College on behalf of the Consumer Bankers Association.* We are very pleased to have this opportunity to appear before you and present our views with respect to the reenactment in an amended form of the Credit Control Act of 1969, which expired on June 30, 1982.

Mr. Chairman, we are familiar with the views that you and several other members of the Committee hold with respect to the role of government controls in the market economy. We must respectfully disagree with that position in light of what we consider to be the important and fundamental principles that are discarded in such an approach. We believe that the prevailing wisdom among professional economists is in agreement with our position.

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* The Association is a nonprofit organization that was organized in October 1919 to provide a voice for the retail banking industry. Since that time, the membership of the Association has grown to over 500 commercial banks of all sizes that are actively engaged in extending consumer credit. Combined, the members of the Association now hold over 70% of all consumer credit outstandings held by commercial banks.

Our national economy has been generally characterized as one shaped by a market mechanism, with, unfortunately, numerous exceptions to the guiding principles of the marketplace. These principles, of course, have long historic roots and are based on thoughtfully developed, fundamental beliefs about the appropriate role of government. In our view, Mr. Chairman, the intervention of government in an attempt to influence market allocations with respect to credit or any other goods or services in our diverse economy produces misallocations, confusion, inefficiencies and costs that can be avoided only by permitting the market to operate.

Recent Experience With Controls

Our Post-Korean War history of direct credit controls has been limited to two situations. The first of these had little direct bearing on credit, while the second had credit as its major focus.

The first experience involved was a general wage and price control program initiated by former President Nixon in 1971. The program attempted to deal with all manner of wages and prices and included, at least technically, both interest and dividends. Under that program, financial institutions were encouraged, primarily through persuasion, to maintain or reduce interest rate levels. Letters were sent to senior management of financial institutions asking them to maintain interest rates at a relatively moderate level.

In that program, control of interest rates seemed to be of less substantial concern than other sectors of the economy, apparently due to the relatively low levels of interest rates vis-a-vis the rates of increase being experienced by other segments of the economy. For example, in his statement before the members of this Committee on October 27, 1971, then Secretary of the Treasury Connally pointed out that, as of August 15, 1971, 90-day Treasury bills were in the range of 4-1/2%. Similarly, immediately before his testimony, the prime rate had been reduced to a level of 5-3/4%, suggesting a lack of need to directly control interest rates.

Presumably, the absence of direct control of interest rates represented a judgment that these rates simply could not be controlled by governmental action. Most certainly this was due at least in part to a recognition that interest rates were not controllable by legislative fiat, but rather were the direct reflection of various factors at work in the economy.

The more recent experience was under the Special Credit Restraint Program adopted at the request of then President Carter on March 14, 1980. Under the Credit Control Act of 1969, a program could be implemented only if requested by the President and then implemented by regulations of the Federal Reserve Board. Under those regulations, the Program consisted of six specific parts:

1. A voluntary Special Credit Restraint Program that applied to all domestic commercial banks, bank holding companies, business credit extended by finance companies, and credit extended to U.S. residents by the U.S. branches and agencies of foreign banks. Under the Program, qualitative rather than quantitative limits were imposed and creditors were asked not to expand credit by more than 6% to 9% over the preceding year. As part of this qualitative approach, the Board established guidelines that included asking institutions to avoid the use of credit resources to support essentially speculative uses of funds. In an attempt to assure that certain credit needs were met, the Board made a special effort to maintain credit for farmers and small businessmen, although even these needs had to fit within the specified expansion range.

2. The Program also included restraints on certain types of consumer credit, including credit cards, check credit overdraft plans, unsecured personal loans and secured

credit where the proceeds were not used to finance the collateral. The Board established a special deposit requirement of 15% for all lenders on increases in covered credit. In an attempt to minimize the impact of the Program on already distressed parts of the economy, automobile credit, credit specifically used to finance the purchase of household goods such as furniture and appliances, home improvement loans, and mortgage credit were not covered by the Program.

3. There was an increase from 8% to 10% in the marginal reserve requirement on the managed liabilities of large banks that had first been imposed October 6, 1979, and a reduction in the base upon which the reserve requirement was calculated.

4. The Board also imposed restraints on the amount of credit raised by large non-member banks by establishing a special deposit requirement of 10% on increases in their managed liabilities.

5. There was an attempt to impose a restraint on the rapid expansion of money market funds by establishing a special deposit requirement of 15% on increases in their total assets above the level of March 14, 1980.

6. Finally, the Board placed a surcharge on discount borrowings by large banks to discourage frequent use of the discount window and to speed bank adjustments in response to

restraint on bank reserves. A surcharge of 3% was applied to borrowings by large banks for more than one week in a row or more than four weeks in any calendar quarter.

The Program continued through July 3, 1980. During that period, the entire banking industry was faced with a confusing and costly array of regulations and questions and answers that attempted to apply a single regulation to an exceedingly diverse and complex credit industry. This sudden imposition of a highly complex and technical regulatory scheme was particularly difficult for small financial institutions to handle. These small businesses simply did not have the expertise or capability to obtain, analyze and follow the regulations and later interpretative material that defined the Program. These institutions, being fully aware of the civil and criminal penalties, were simply unable to deal with the complexity and cost placed upon them by the Program.

In part due to the uncertainties in the Program, it had the practical effect of substantially slowing credit availability throughout the market. Later studies indicated that despite efforts to "carve out" special areas in dire need of access to credit markets (such as automobile sales and housing), the overall effect was to shock creditors and borrowers alike into an across-the-board cut back of credit that negatively affected all sectors, including those that could ill-afford any cut back. This was not only the reaction of many of our members, but, as described in the Federal Reserve Board's testimony earlier this week, a substantial number of other creditors responded with a similar "shut down" of credit.

The damage to the financial system was difficult to quantify. One study, however, which will undoubtedly be discussed in greater detail by other witnesses, showed that the cost to the economy was substantial. According to that study, the brief four-month intervention of government into the credit market resulted in a loss in GNP of $23 billion, a loss of 300,000 man years in employment, a loss of 500,000 new car sales and a loss in building starts of 50,000 units.

Clearly, the costs under this Program, which lasted a total of less than four months, was substantial, while the real benefits, if any, were slight.

Credit Controls Disrupt and Injure the Economy

Against this limited background, the Subcommittee is considering the desirability of credit controls. Based on these experiences and basic principles of our market economy, we continue to believe that credit controls serve no constructive purpose.

The fundamental starting point in analyzing credit controls must be the basic American concept of a competitive market operating within a free enterprise system. As a general proposition, based on strongly held and well-developed political and social views, the American economy has long been characterized as basically a market economy. While the past half-century has witnessed extensive growth in government intervention, quite clearly the current trend is to learn from that at best checkered experience and move away from intervention.

Historically, artificial price controls have been rejected as being an unacceptable mechanism for allocating or pricing goods and services. As a form of price control, credit controls fare no better under contemporary analysis.

Generally speaking, proponents of credit controls in its various forms stress that these arbitrary methods of dealing with the economy will mitigate inflation by improving productivity and reducing excess or unwanted demand. However, a careful examination of these premises reveals that these approaches are undoubtedly well meant, but misguided responses to the problems facing our economy.

Inflation has abated significantly to far less than the double digit levels of two years ago and there has been some, although not adequate, relief for the record interest rates that existed on March 14, 1980. If credit controls are to be used selectively and as a discriminatory tool for arbitrary policy as indicated in the June 28 press release, however, then the following analysis will be in order.

It is fallacious, arbitrary and misguided to believe that credit controls help ease inflation-caused high rates of interest or place lendable funds in the "right place" to improve employment by prohibiting "unproductive" loans and channeling the funds to more "productive" uses. It is virtually impossible to define a productive loan without being arbitrary, subjective or unfair. Using credit for producing food, clothing and housing certainly are worthwhile, but what about using credit for ice cream, video tapes, designer jeans, and alcoholic beverages? Are these not productive as well? Even a basic crop, such as soy beans, could not be clearly categorized as "productive" if there were a soy bean surplus in existence at the time. The whole issue of definition is fraught with value judgments.

As aptly described before this Committee seven years ago by then Federal Reserve Board Chairman Arthur Burns, these questions involve sociopolitical judgments of the highest order.

> Decisions as to social priorities in the use of credit are inherently political in character. If such decisions are to be made at all, they should be made by the Congress -- not by an administrative and nonpolitical body such as the Federal Reserve. After all, tilting credit in favor of some borrowers implies denying credit to someone else. Our economy has developed by relying mainly on the market to make such decisions. The market reflects the interaction of many thousands of

borrowers and lenders. If the day ever arrives when governmental decisions are to be substituted for individual preferences expressed in the market place, then the priorities should be set explicitly by the Congress.

The specifications of H.R. 212 are so vague and general that they would inevitably involve the Board in political judgments -- an area in which it obviously has no special competence. For example, the bill requires the Board to allocate credit toward "essential and productive investment." But how are we to evaluate the credit needs of public utilities relative to the needs of defense contractors? Are we to favor the credit needs of "small business and agriculture," as the act requires, even if that means that large corporations will be denied the credit needed to keep their employees working? Are we to favor the automobile manufacturer who turns out cars that suit our concept of what is socially desirable and punish the manufacturer whose cars fail to pass our test of social utility? And since the act requires the Board to move credit away from financial activities such as corporate acquisitions, would we have to deny credit to finance a merger of two firms, even though such a merger is expected to result in a strong enterprise that can better expand job opportunities in its area? Questions such as these may be multiplied by the hundreds and thousands.

> *Proposed Bill to Cover Interest Rates and Allocate Credit: Hearings in H.R. 212 Before the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Currency and Housing*, 94th Cong., 1st Sess. 204 (1975) (Statement of Hon. Arthur F. Burns)

Moreover, it is important to recognize that there are a series of risks that accompany the imposition of controls. As outlined in an article which is attached to our testimony, one authority has identified five specific risks that are associated with imposing regulatory schemes of the type envisioned in the proposed legislation.

First is the sheer risk of regulatory growth under which the regulatory system, once established, continues to grow as it attempts to deal with the complexity of the area being regulated. This is demonstrated by the 1980 Credit Control Program in which the original regulation was amended in the course of less than three weeks and which, in its very brief 3½ month life, was the subject of numerous and voluminous questions and answers.

Second, the risk of regulatory accidents exists. These risks involve the sometimes undesirable and often unintended results of regulatory action. For example, during the 1980 Credit Control Program, limitations on credit card use (or perceptions by consumers that credit card use was being limited) caused a sharp reduction in open-end credit which, without serious question, injured small businesses such as retailers who were specifically exempted from coverage under the Program for the reason that they were to be spared injury.

Third, there is the risk of unfairness in the system. Any regulatory system will have uneven impacts on various segments of the society and it is virtually impossible to design a complex system that is "fair" to all segments of the society. Again using the 1980 Credit Control Program as an example, consumers who were attempting to enter the credit market during that Program, despite their possible needs or definite preferences for obtaining consumer credit, were arbitrarily and therefore unfairly excluded from the credit system by the Program.

Fourth, there is the risk of regulatory lag that results when problems in the system are identified but cannot be resolved immediately. This risk means that problems created by the Program introducing unfair or unintended results will go uncorrected for at least some period during which these perverse impacts of the Program will continue unimpeded.

Fifth, and finally, is a risk attached to any regulation that deals with complex issues in a piecemeal fashion. A regulation that deals with only one segment of a highly complex and interdependent economy (for instance, credit controls) will invariably cause disruptions within the economy and dislocations in favor of areas not subject to that regulation. Once again, the 1980 Credit Control Program provides an excellent example. "Covered credit"

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excluded most forms of secured credit. Thus, in order to avoid the impact of the Program, all a creditor had to do was to extend credit on a secured rather than an unsecured basis and the creditor could thereby avoid coverage under the program. Presumably, there was nothing inherent in secured credit that commended its use over that of unsecured credit. In fact, if this rule had any impact, given the greater costs associated with secured credit, it would seem to have increased credit costs for creditors and, accordingly, for the consumer who obtained the credit.

All of these risks, of course, create costs. From the visible costs of setting up and complying with a complex regulatory mechanism to the less visible costs of the disruptions that flow from altering market allocations of credit, these risks will inevitably create greater systemic costs.

Two examples of government intervention in monetary matters make it unnecessary to speculate about whether non-market mechanisms are any more desirable in the credit area than in any other. The first involves attempts to replace the free market with government restrictions on the amount of interest being paid by financial institutions, commonly referred to as Regulation Q. For about the past fifteen years, government controls on the amount of interest payable to depositors have created an ever-increasing divergence between what the law permitted depository institutions to pay and a fair market return to consumers.

Not surprisingly, the market found ways to avoid these limitations. Money market mutual funds, among others, have filled this gap and now hold in excess of $200 billion, when only two years ago they held less than $20 million. Price controls calculated to "help" an industry at the expense of the small saver have contributed significantly to its current problems of shrinking deposits.

As a result of this price control on the amount of interest that financial institutions can offer to their consumer depositors, it has been estimated that during 1981, the small savers lost $25 billion in interest by maintaining their accounts at financial institutions subject to Regulation Q ceilings. The most recent entrants into the money market fund such as Sears Roebuck and AAA are now offering market rates of more than 13% on an initial deposit of $1,000 while financial institutions can only offer 5¼ to 5½% on a passbook account.

It should also be noted that this form of price control has produced distortions of credit availability in small or medium-sized communities. Most money market funds invest consumer deposits they receive in large certificates of deposit offered by money center banks, or in government securities. Essentially, the funds are no longer available in local communities to finance homes, automobile purchases, small businesses or local farmers. The Regulation Q debacle vividly demonstrates that the imposition of controls on the market only leads to a result contrary to that intended by the regulation, since the market will operate to circumvent these controls.

There is no reason to believe that government controls on the types or amounts of credit banks can offer or the amounts of interest paid *to* financial institutions rather than *by* them are any more effective or efficient at meeting their stated objectives.

A second example is provided by the piecemeal efforts -- at both the state and federal levels -- to deregulate price controls on money by lifting or changing some but not all usury ceilings. Under the Depository Institutions Deregulation and Monetary Control Act, for instance, mortgage lending and business and agricultural credit were afforded different treatment from that given to general consumer credit. Can there be any serious doubt but that creditors in low rate environments would seek to make profitable loans in unregulated areas rather than unprofitable loans that are subject to severe ceilings? This inevitable channeling of funds -- regardless of the preferences of the consumer as to what he or she wants to use credit for -- is descriptive of credit allocation not by the market but by arbitrary governmental rate ceilings.

Usury ceilings have caused severe distortions and inefficiencies. As will be noted, among other perverse results, they operate to allocate credit away from certain consumer financing activity.

There is clear evidence that disruptions have been produced by usury laws. An illustrative economic inefficiency is that lenders and other creditors are unable to charge prices for credit services that are commensurate with their costs. Since these entities, in order to survive, must operate at a profit, such unprofitable transactions must be subsidized through rates charged on other transactions or for other credit services. The matrix of usury laws and pricing restrictions creates a series of subsidies and dislocations -- including cash purchasers subsidizing more affluent credit purchasers, and credit card users who use and pay for credit subsidizing convenience users who do not pay for a valuable payment mechanism. As a result of these controls and restrictions, the cost to some consumers is too low, while that to others is too high, relative to the actual cost of the service involved.

In short, Mr. Chairman, the disruptions caused by government interference in credit markets provide vivid evidence that the market approach that characterizes virtually all other segments of the American economy should apply equally to credit. A failure to recognize this fundamental fact will subject an already capital-short financial sector to even greater competition for capital from other sectors. If credit controls force changes or influence credit channeling -- or even create an uncertain climate in which such action might occur -- an industry now having great difficulties in attracting capital will be presented with an impossible task.

Credit Extended For Acquisitions

One of the items mentioned in the news release announcing these hearings was the use of credit for "nonproductive purposes" referring to corporate takeovers. Several points must be addressed.

First, the principal factor that influences the operation of credit markets is demand. Demand is generated by a large number of diverse borrowers and potential borrowers seeking credit for a multitude of purposes. The market, without the artificial constraints of government intervention, produces financing that is steered by market forces, thus allowing the smooth operation of a highly complex economy. Any attempt to identify a segment of that interdependent economy and the credit that supports it as "nonproductive" will have impacts and implications throughout the economy that are literally impossible to anticipate. For example, is credit to finance an acquisition "nonproductive" when it is funding the buy-out of a company owned by a person retiring from the business, thus keeping the business alive, products and services available and employees employed? In addition, new executives may be able to manage a company's resources more efficiently than old ones, thus increasing productivity. Furthermore, the mere threat of a takeover encourages managers to operate more effectively.

According to data gathered by the Federal Reserve Board in the course of the 1980 Credit Restraint Program, more than 50% of acquisition loans involved $1 million or less. Thus, any program that merely attacks in a broadside fashion "acquisition credit" as "nonproductive," apparently assuming it is used for large, speculative ventures, simply fails to appreciate the complexity of the credit market and the diversity of the transactions affected.

Second, merely declaring acquisitions to be "nonproductive" fails to follow the impact of credit beyond its first use. The funds that are used in connection with takeovers, mergers and acquisitions do not leave the economic system when they have performed their function. Rather, they are distributed to other participants in this highly complex system who then place those resources back into the stream of the economy. Thus, credit that is used for acquisitions simply does not leave the system, but rather passes through from one segment of the economy to another.

Third, the market, functioning on an international as well as a national basis, continues to act as the predominant factor in the flow of credit. When credit extenders are unable to receive a fair market yield in one portion of the credit market, they will simply place their resources elsewhere. A perfect example reflecting this fundamental economic principle involves the dislocations caused by usury ceilings.

In the news release announcing these hearings, reference is made to funds that might have been used, for example, for automobile purchases. Yet lenders wanting to provide financing in that market are subject to a complex patchwork of price controls in the form of state usury laws that limit the amount they can charge for that credit. Earlier in this Congress, this Subcommittee heard the Association and others testify that the imposition of price controls would produce a reduction in the availability of credit in areas subject to usury ceilings. One rational market response to this governmental intervention is to channel funds into areas that are not subject to these controls and thus offer the possibility of a reasonable yield. While not agreeing that credit extended in these areas exempted from usury laws is "nonproductive" credit, we would agree that, as a result of state usury ceilings, credit to these areas of the economy might make credit to areas subject to price controls less available.

In short, Mr. Chairman, we do not believe that it is possible or fair to brand any one type of credit nonproductive. Furthermore, so characterizing any type of credit necessarily involves exceedingly difficult decisions that are better made by the market than by government action.

As in any market environment, of course, the market may operate in ways that to some, applying their own socioeconomic and philosophical values, are inappropriate or "nonproductive." Even if one were to accept the premise that such credit extensions exist, however, it is critical to weigh the nature and extent of the problem and its damage against the cost and damage caused by what may be perceived to be the cure. If there are elements within the exceedingly large and diverse credit market that permit funds to be allocated for purposes that some assert to be less than fully productive, what are the costs to the rest of the credit system to attempt to eliminate that situation?

Mr. Chairman, we earnestly believe that even if certain transactions take place which some argue are nonproductive, the damage to the overall credit system and the economy as a whole that could result from interfering with the market would be far more destructive than any relatively minor non-productive deviations that the market might permit.

Less Than Two Years Ago Congress Rejected Credit Controls

Not only do we believe that the concept of credit controls is flawed, but we also would like to note that Congress itself recently rejected the desirability of credit controls by "sunsetting" the statute.

During the Senate consideration of S.2352 in June of 1980, Senator Armstrong proposed an amendment terminating the Credit Control Act as of July 1, 1981. Senator Armstrong referred to the Credit Control Act as "an accident waiting to happen," referring to President Carter's March 14, 1980 imposition of credit controls. Senator William Proxmire, then Chairman of the Senate Banking Committee, supported the amendment, noting the "unfortunate effect" that the President's imposition of credit controls carried with it. Senators Heinz and Helms also spoke strongly in favor of the amendment.

The Armstrong amendment passed the Senate by a vote of 43-40. The bill of which it was a part, S.2352 passed the Senate by a vote of 72-11.

The Senate and House version of the bill differed due to the Senate's insistence on the Credit Control Act sunset provision. The Senate requested a conference and appointed

Senators Proxmire, Williams, Cranston, Stevenson, Garn, Heinz, and Armstrong as conferees, who were able to reach agreement with the House. Under the compromise, the sunset of the Credit Control Act was postponed until June 30, 1982. The Senate agreed to that revision on November 21, 1980, and the bill was signed into law on December 30.

The Senate discussion of the sunset provision evidences strong support for the repeal of the Credit Control Act. The amendment had strong Democratic support in the votes of Senator Proxmire and Bayh, among others. The overwhelming vote by which S.2352 was adopted indicates a strong bipartisan commitment to the entire package, which included the Credit Control Act sunset provision.

The House version of the bill, as noted above, originally did not include the sunset provision. But when the amendment was insisted upon by the Senate, the House agreed to the amendment by a voice vote, indicating its concurrence in the goal of ending credit control authorization. Indeed, in his supporting remarks prior to the House passage of S.2352, Representative Stanton stated that the "most important" provision of the bill was the sunset of the Credit Control Act. He stated that the President's credit restraint program "has had no demonstrable impact on inflation, it has had a negative impact on our nation's growth."

Comments On H.R. 6124

The language proposed in H.R. 6124 provides an excellent illustration of the complexities involved in attempting to regulate any portion of the credit market while maintaining reasonable limitations or restrictions on the degree of regulatory intervention in that market. As introduced, the legislation would seem to permit the President to invoke credit controls at virtually any time based on a perception that a problem exists or might exist with respect to unemployment in any sector of the economy or with regard to inflation or recession. Given our recent history, it seems highly likely that at any point it could be fairly and reasonably argued that one or more of these conditions exists or there is the potential that it may exist. Thus, the proposed amendment would permit the creation of a credit control program by a President upon any conceivable combination of economic factors, thereby putting the matter totally within unbridled presidential discretion.

Once the program has been invoked, the Federal Reserve Board would then be given virtually limitless powers to regulate the credit market. In the version of the legislation that expired last June 30, many observers felt that the Board already had essentially limitless power. In the words of former Board Chairman Burns, the Act provided the Board with "dictatorial powers over the economy." The proposed legislation would expand the "dictatorial power" even further.

By permitting the Federal Reserve Board to provide limitations on credit for "nonproductive purposes" the Congress would be delegating to the Board the role of total economic decision-making and credit market design. Given this authority, presumably the Board could reach the conclusion that Americans spend too much money on new automobiles or on houses, declare that these were no longer "productive" purposes for credit and thus outlaw the use of credit for these purposes. Similarly, the Board could decide that all forms of consumer credit were not "productive" because of concerns over the ability of consumers as a whole to meet their obligations and therefore declare that only business purpose credit could be extended. The same ambiguities would exist when the Board decided to exercise its authority to assure credit for "productive and necessary purposes."

To delegate such authority to a seven-member board where members serve a 14-year term effectively beyond political control is simply beyond any reasonable or appropriate level of delegation. It does not speak ill of the Federal Reserve Board or any of its members to suggest that such an approach is improper and far beyond the bounds of sound governmental, let alone, economic policy.

Conclusion

Mr. Chairman, we join with you in your concerns about the current state of the economy and the level of interest rates.

While some may argue that government controls would provide an effective and painless "quick fix," we sincerely believe that further government intervention in the market would be neither effective nor painless. The problems are complex and many years in the making. They simply do not lend themselves to simple, quick solutions, despite the superficial appeal that those solutions might present. The single solution, as frustrating, painful and deliberate as it may be, is to devise a steady strategy combining both fiscal and monetary restraint within a market economy that is permitted to operate with a minimum of government involvement.

Thank you for providing us with this opportunity to testify.

The credit control program of March 14, 1980 raises significant questions not only about this particular action, but also about the broader issue of regulatory intervention. What are the risks of the Federal Reserve Board taking action largely in isolation of other actions affecting credit? What are some of the likely but unintended consequences of the program? What issues does this raise about the formulation of federal credit policies? Most importantly, what steps can the Board take to ensure that future policymakers learn from this experience?

Consumer Credit Controls: Risks and Lessons

STANLEY E. MORRIS

On Friday, March 14, 1980, at 4:30 p.m., shortly after the east coast market closings, President Jimmy Carter walked into the East Room of the White House to deliver a hastily prepared economic address to the nation. The delivery was halting. So quickly was the material put together that one page in support of reducing regulation on the American economy was skipped over. According to Alfred Kahn, the President's inflation advisor and most avid deregulator, two pages simply got "stuck together" and the President passed over them. There was no policy decision to delete the page. The absence of that page was not particularly important because it simply restated previous support for various Executive and Congressional deregulation initiatives in such sectors as trucking, banking, and communications.

The delivered part of the address included a grab bag of actions—from a commitment to balance the budget, to a proposal to triple the staff of the White House wage and price monitors. Perhaps the most significant announcement was the President's decision to trigger the sweeping powers of the Credit Control Act of 1969. Thus, while a statement supporting deregulation was inadvertently dropped, a major new regulatory program was established. An additional irony, if the press reports were accurate, was that the

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strongest proponent of credit controls in the White House was the deregulator, Alfred Kahn.

The signals from the Federal Reserve Board implied that this was a job they did not want. Nevertheless, on the same day, the Fed issued forty-eight pages of background and guidance on the new regulatory program. Eight new reporting programs were put in place within a week. Within two weeks a sixteen-page question and answer handout was distributed for clarification. Several technical amendments already have been made to the original regulations. Just ten days after the announcement, the *Legal Times of Washington* reported the following:

> Finance lawyers last week were getting a tantalizing whiff of the added legal business that suddenly is generated when the federal government begins enforcing a new anti-inflation program. Imposition of the Federal Reserve Board's new credit controls sent both lending and consumer oriented attorneys scurrying after clarifications, loopholes and advance enforcement information.[1]

Although it can be argued that the Federal Reserve Board's actions were modest, it is clear that a new and significant federal regulatory intervention in the private sector credit markets was established.

The purpose of this article is not to describe how these credit rules work or what bankers and others need to know to comply with them. Instead, the focus is on the longer term policy issues surfaced by the program, some of the problems and risks with such a regulatory scheme, and the lessons that might be learned from this experience.

Background

The actions taken by the Federal Reserve Board fell into two general categories:[2] (1) an expansion of the monetary policy enforcement tools to increase marginal reserve requirements on member banks, extension of the requirement to nonmember banks and money market funds and further discouragement for large banks to borrow frequently from the Federal Reserve; (2) a special program to restrain consumer borrowing by conducting a voluntary program to discourage banks, finance companies and others from giving certain kinds of loans and by setting a special reserve requirement on credit cards and other kinds of credit to reduce consumer borrowing. It is the second category that raises the significant regulatory questions and is the subject of this article.

Although it can be argued that the Federal Reserve Board's actions were modest, it is clear that a new and significant federal regulatory intervention in the private sector credit markets was established.

Twice since World War II, the Federal Reserve has imposed credit controls: first in the fall of 1948 and again at the outset of the Korean War. By any measure, past approaches to controls were much more interventionist and complex than the recent action. The objective of the controls was to reduce demand for certain items that were in short supply. For example, the terms of loans were established through regulation on certain kinds of durable goods, particularly automobiles. In both cases the controls gradually faded away. It is interesting to note that in the only peacetime experience with such controls—1948—they were imposed just as the economy was slipping into a recession. Although these control programs clearly affected consumer purchasing behavior on certain commodities, there is little evidence or theory about their impact on the total level of consumer expenditures. Consequently, there is no evidence that consumer controls affect the overall inflation rate.[3]

Despite the questionable success of this past experience, Congress in 1969 passed banking legislation including presidential standby authority to order the Federal Reserve Board to exercise extraordinary powers to control credit. Although at that time the inflation rate was nowhere near recent levels, (e.g., congressional investigations were held when the prime rate was raised to 8½%) Congress was concerned about the prob-

Both the voluntary program and the set-aside program are filled with exceptions. . . This is when complicated legal interpretations arise and where the risks of confusing and inexorable regulatory burdens occur.

lem, and this action allowed them to pass the responsibility to the President.

The final legislation was a compromise between the Senate and the House. The compromise was to adopt the provisions of both Houses, one a provision for a voluntary credit control authority and the other the standby authority to direct the Fed to control credit.[4] The authority in the law is awesome. When authorized by the President, the Board may "regulate any or all extensions of credit . . . prescribe the maximum amount, the interest rate or other terms . . . and prohibit or limit any extension of credit under any circumstances the Board deems appropriate." Both civil and criminal penalties for noncompliance are provided, including up to a year in prison.[5] In a message dated Christmas Eve 1969, President Nixon called these credit control provisions "unnecessary and undesirable" and observed that the "controls, if invoked would take the Nation a long step toward a directly controlled economy."[6] Nevertheless, because he viewed other provisions as important, he signed the bill. Until March 14, 1980 it lay dormant. Even in 1971 when President Nixon imposed wage and price controls on the economy, it was decided not to try to control credit directly. As a result, more is probably known about the issues and effects of wage and price controls than is known about selective credit allocation and controls.

President Carter's Action of March 14

The statute only allows the President to authorize the Federal Reserve to establish a program of credit controls. He has no authority to determine the nature of the program or to set ground rules on the Fed's actions. Executive Order 12201, signed by President Carter on March 14, simply triggered the authority; it provided no guidance. However, the President said that it would be implemented "on a carefully targeted basis" with special attention "to be given to the particular needs of small business, farmers and homeowners."[7]

The Fed's Response

The Federal Reserve Board took the following actions in its effort to restrain consumer credit activity: first, it imposed a voluntary and largely hortatory program of credit restraint on all domestic commercial banks, bank holding companies, finance companies and foreign banks who lend to U.S. citizens. Second, with certain important exceptions, all creditors with outstanding consumer credit exceeding $2 million were required to maintain a special non-interest bearing deposit with the Federal Reserve equal to 15% of any *increase* in credit outstanding after March 14, 1980.

This approach avoids the federal government making loan decisions or setting the criteria for certain loans as was done in 1948 and 1950. It dampens the creditor's interest in giving loans and, if interest rates are raised, presumably dampens the consumer's interest in seeking out loans. If the action treats everyone equally, all credit allocation is made by the private sector and all that occurs is that the Board has raised the cost of money, as it does routinely in implementing monetary policy. However, President Carter wanted a carefully targeted program that explicitly does not treat everyone equally. Both the voluntary program and the set-aside programs are filled with exceptions. Some loans are covered and some are not. This is the regulatory dilemma that the Fed faces. This is where complicated legal interpretations arise and where the risks of confusing and inexorable regulatory burdens occur.

The Fed's program is actually less targeted towards certain kinds of undesirable credit activity than it is focused on certain types of desirable loans which should be encouraged. Thus, most home loans and automobile loans are not covered by the program. Loans for utility users, student loans or any government guaranteed loans are not covered. Home improvement loans that are secured are exempt. In fact most secured loans are not covered. One result of this targeting of the credit control program or, more accurately, protecting special interests, is the creation of a regulatory maze from which crafty lawyers, for a fee, can design roadmaps for escape. For example, it was reported that "... creditors, especially retailers can be expected to cut back on the amount of unsecured credit issued, in favor of secured credit which is exempt. 'The obvious answer is to take a security interest in the goods,' said William J. O'Connor Jr., of Phillips, Lytle, Hitchcock, Blaine and Huber of Buffalo. 'It complicates the transaction process, but it gets you out from under the controls.' "[8]

To address efforts to circumvent the program, the Fed issued several technical amendments to close loopholes and otherwise further complicate the private market system of credit allocation. It is not clear that the Fed can carefully target the program to protect certain interests. No guidelines are provided on the voluntary program, and definitions immediately become a problem. Also, some questions arise about the President's intent. When he asked that special consideration be given to small businessmen, farmers and homeowners, did he also mean that their credit cards would be given special preference? Like all regulatory agencies with new responsibilities, the Fed struggled to define the rules. A look at the March 26, 1980 question and answer press release is instructive:

> Q. As a number of institutions do not secure small home improvement loans with a mortgage on the home, are such loans to be treated as covered credit?
>
> A. Yes. Unsecured home improvement loans and home improvement loans secured by collateral other than the home (or a savings deposit) are treated as covered credit.
>
> Q. A borrower refinances his automobile loan with the original lender. The original loan was not covered credit. Does the refinancing constitute covered credit?
>
> A. Refinancings of exempt credit with the original creditor do not constitute covered credit. However, if additional funds beyond the outstanding balance are provided to the borrower, that additional amount would constitute covered credit. If refinancing is obtained through a creditor other than the original creditor, the entire amount of the refinancing would constitute covered credit.[9]

What economic sense does any of this make? If there is one lesson from a study of the history of regulation, it is that matters become increasingly complex and often it is only the specialist lawyers who can fathom the resulting maze.

Another pattern of regulation is that often undesirable and unintended consequences result from well-intentioned requirements.

The Risks of Regulation

Regulatory agencies follow certain patterns as they implement new regulatory schemes. The lessons derived from other regulatory experiences provide an appreciation of the risks inherent in credit allocation regulation. Some of these patterns were evident early in the Fed's program.

Risks of Regulatory Growth. Because regulation often breeds more regulation, extreme care must be exercised so that the government does not slip deeper and deeper into decisions best left to the private sector. The incentives to expand regulatory intervention are often compelling, as can be seen from the experience with energy regulation. In order to reduce dependence on foreign oil, voluntary programs of fuel conservation were established. A year ago, mandatory temperature restrictions were set for almost all public buildings. Now the federal government is proposing a set of national building codes to mandate certain "energy efficient" practice for all construction. Serious consideration has even been given to setting temperature restrictions in all homes. Although the bureaucratic enforcement of such programs raises serious problems, each rule seems to encourage the development of newer, more pervasive rules. Thus far, the Fed has largely succeeded in resisting this tendency.

Risks of Regulatory Accident. Another pattern of regulation is that often undesirable and unintended consequences result from well-intentioned requirements. The history of regulation abounds with examples of government action growing in ways the originators never anticipated. The railroads that supported bringing trucking under the jurisdiction of the Interstate Commerce Commission in the 1930s did not realize the complicated regulatory maze that would ensue. The resultant demise of many railroads and the dramatic increase in legally trained railroad executives is witness to a situation where dealing with the ICC soon became more important than moving goods or passengers. More recently regulations have required public transit systems to allow the handicapped equal access to their transportation services. The costs of retrofitting mass transit are enormous. Thus the cost of service will doubtlessly rise just as the government, for energy and environmental reasons, is trying to encourage greater use of public transit. The credit control rules seem to have had similar unintended consequences.

The Wall Street Journal reported that the squeeze on credit cards as a result of the 15% reserve requirement will benefit big retail stores who can afford to offer their own credit cards. "As a result, larger merchants that issue their own credit cards will gain business lost by small and medium-sized stores that rely on bank cards for most of their credit sales."[10] Consequently, by trying to discriminate among different kinds of credit activity, the program runs the risk of injuring small businesses and aiding large ones. This irony results from the fact that many small businessmen rely on the availability of consumer credit for survival. A program with special provisions to protect small businessmen as borrowers may end up hurting the many small businesses who rely on customer credit.

Regulators, if they discover the unintended consequences of their action and the unfair application of the rules, will take steps to repair the problems. However, these efforts seem to run well behind the quick changes that occur in the private market.

Risks of Regulatory Inequities. It is not uncommon for regulation to result in unfairness to certain vulnerable groups in society. "Controls create inequities, and the greatest inequity is their effect on the average American family."[11] President Carter made this statement in his March 14 address when speaking about wage and price controls. It applies to credit controls as well. For everyone favored in the credit market, someone is disfavored. Most regulation disproportionately injures the small businessman, small organization or individual of limited means. These groups have less flexibility and fewer alternatives in responding to new requirements than does the wealthy individual or large corporation. It is unlikely that homes in Beverly Hills will undergo fewer improvements or shops on Fifth Avenue will feel a significant sales reduction as a consequence of credit controls. Meanwhile, individuals just establishing credit feel the brunt of the program. No economic analysis of credit controls was provided by the Fed. Therefore, we do not know what these inequities are likely to be. However, President Carter's statement has the ring of truth. If the controls were to be kept on for any length of time, greater inequities would no doubt be discovered.

Risks of Regulatory Lag. Regulators, if they discover the unintended consequences of their actions and the unfair application of the rules, will take steps to repair the problems. However, these efforts seem to run well behind the quick changes that occur in the private market. For example, the increase in consumer demand for smaller, more fuel efficient automobiles caught both the regulators and the U.S. automobile industry unprepared and may soon make the regulations on automobile fuel economy standards largely irrelevent. The growth of bank regulation has often been a reaction to past problems often created by previous regulatory actions. The dramatic changes in banking in the past few years, as outlined in John Heimann's article in *The Journal of Retail Banking*[12] (December 1979), have occurred within a regulatory environment that simply has not kept pace.

The Depository Institutions Deregulation and Monetary Control Act of 1980 (P.L. 96-221), signed on March 31, 1980, is filled with fixes to regulatory problems that were created by previous efforts to solve other problems. The removal of Regulation Q, the increase in the tools available for the execution of monetary policy and the expansion of NOW accounts are largely responses to the reality of financial market changes that have simply passed the regulators by. It is almost inevitable that new fixes will be required in a few years to fix the current fixes. Similarly, the Fed's steps at unraveling the credit control program may run well behind the onsetting recession.

Risks of Piecemeal Regulation. Not only is there a risk that regulators will back into situations they did not plan, there is an equally serious risk that they will concentrate their attention on parts of a problem and fail to see it comprehensively. The tree will be clear but the forest will be missed. For example, in our compassion to deal with the transportation problems of the handicapped, we ignore the goal of encouraging mass transit growth. In our enthusiasm to encourage coal use as an alternative to fuel oil, we ignore the health and environmental consequences of such usage. The credit restraint program of 1980 follows this regulatory pattern. It is routine for regulatory agencies to be uninterested in issues or problems over which they do not have explicit authority. Thus, they tend to focus narrowly on problems that are almost always more complex. This is nowhere more true than in the credit area.

To understand the nature of this piecemeal approach and its problems, it is necessary to examine not simply what the Board did but why it thinks it did it. The Federal Reserve Board was careful in the materials distributed on March 14, 1980 to explain why it took the steps that it did.

> These actions are being taken to curb inflationary pressures. Continuing growth of consumer credit has contributed to inflationary forces by helping to sustain consumer demand for goods and services. As a consequence of this sustained high level of demand savings in the economy have fallen to the lowest level since the Korean War. Restraint on consumer credit will tend to encourage additional savings, which can be channeled to productive investment to increase the supply of goods. At the same time, consumer demands for the supply of goods available will be restrained. In both of these ways, restraint on consumer credit will contribute to dampening inflationary forces. The particular types of credit to which these restraints will apply are those generally showing undue strength in recent months. Thus automobile credit, and credit extended to purchase the collateral will not be affected by this action.[13]

It is unlikely that anyone on the Federal Reserve Board actually believes this. It might have some plausibility if the Fed's action had been taken in complete isolation of any other policies. As pointed out earlier, there is no evidence that previous programs of credit allocation had any effect on inflation. It is not clear that the Fed knew how much credit activity actually would be affected by the program. Despite the Fed's usual penchant for providing large amounts of quantitative data and tables, none was provided in the press release on consumer credit controls. It is easy to see why.

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The major component of the Fed's restraint program focuses on revolving credit, which stood at $54 billion in December 1979. The program discourages any net increase in these levels. However, automobile loans, which are exempt, are twice the size of revolving credit. Home mortgages, which are also exempt, make up about $1.3 trillion or twenty five times the level of revolving credit.[14] It is difficult to see how the grandiose objectives of the program are to be accomplished if the focus is on such a small part of credit activity.

If the Board believed that the price of goods and services had been driven up by high level demand, it did not provide any indication of where these problem areas were. In fact, the kind of program chosen is inadequate in dealing with specific sector problems. If this is the problem, then the Board should have provided guidelines to lenders about what areas are particularly vulnerable to excessive demand. The current program affects equally credit for business lunches, gasoline purchases, airlines trips and hardware supplies. Much of this credit activity is not excessive consumer demand but simply credit card convenience. Is the consumer restraint program dealing with a behavior problem? If so, is credit card use economically undesirable? The Fed's failure to define comprehensively the problem is typical of much regulation. However, the Fed may have made a more serious error by focusing on private sector lending practices and ignoring the predominant role of the federal government in credit policy.

The Conflicts in Federal Credit Policies

The Federal government's central role in the credit markets is ignored in the materials provided by the Board. Nevertheless, these policies are integral to any anti-inflation credit control program. The Board would probably not argue that a small set-aside program can overcome the economic effects of major federal policies and credit activities. For example, fiscal policies may be more important, and the President has committed to a balanced budget in 1981, which could reduce the federal government's borrowing in the credit markets and thus reduce inflationary pressures. But there are strong government counterforces to retard the Fed in achieving its goal.

> *. . . the Fed may have made a more serious error by focusing on private sector lending practices and ignoring the predominant role of the federal government in credit policy.*

Conflicting Tax and Regulatory Policies. As any first year economics student knows and almost every taxpayer soon realizes, it is the explicit policy of the government to encourage borrowing and discourage savings. Consumers are rewarded for borrowing by being able to deduct their interest costs, and they are penalized from saving by paying taxes on their earned interest. As inflation pushes more people into higher tax brackets, they realize the economic wisdom of debt. Although the Board was silent on this fact, President Carter addressed it in his speech. Unfortunately, it appears he got it backwards.

He called for mandatory withholding on savings interest. On the one hand, government complains people are not saving. On the other hand, government holds down interest rates on savings accounts, rewards those who borrow and penalizes through taxes those who save, and proposes to tax earlier the savings interest earned. In addition, regulations make sure that only those with considerable means can use savings vehicles that approximate market rates of return. When entrepreneurs see this inequity, they set up special devices to attract capital. The growth of money market funds is a market response to regulatory constraints elsewhere. Typical of regulators throughout the years, the Fed's response was not to try to remove the regulatory impediments that have resulted in the phenomenal growth of money market funds, but to regulate them in a way to make them less attractive, thereby discouraging saving. It is clear that the Fed's concern for reducing consumer credit activity in order to "encourage additional savings" is directly contrary to other tax and regulatory policies. Rather than addressing these discrepancies, they are ignored. Again, this is not atypical of other federal regulatory patterns, but the credit area may be even more complex.

Conflicting Lending Policies. Not only is the federal government key in setting credit policy through its tax, regulatory and borrowing practices, it also plays an increasingly significant role as a lender. Certain groups have special credit needs and requirements which the government determines from time to time are not being met adequately by the private markets. Consequently, the federal government provides direct loans or insures or guarantees loans to certain special interests. The size and growth of this little understood activity is astounding. Up until quite recently no accurate figures were kept on this loan activity and no controls over it exist today. Loan guarantees are seldom given more than passing attention in the budget process because expenditures only show up after a default has occurred. The 1981 *Special Analyses of the Budget*[15] for the first time describes comprehensively all federal credit activity. It would no doubt be shocking to bankers that in the past the government did not even know what its total loan portfolio was. The latest figures are revealing.

> *. . . the Fed's response was not to try to remove the regulatory impediments that have resulted in the phenomenal growth of money market funds, but to regulate them in a way to make them less attractive, thereby discouraging saving.*

The FY 1981 budget projected loans and loan guarantees of $670.7 billion—an increase of over 30% since 1979 and over three times the level of 1970. As the federal government stands behind these loans, they are essentially risk free. Borrowers without such backing must pay much higher interest or get squeezed out of the market entirely. One-sixth of the outstanding credit in the United States has federal government backing. Needless to say, politics plays an important role in determining which groups in the society receive these credit advantages. The Federal Reserve Board has no responsibility for this activity and, consequently, its consumer restraint program ignored it. Clearly, however, an increase of approximately 30% in credit growth for certain groups contributes to inflation and higher interest rates. In fact the $142.6 billion *increase* since 1979 is almost three times the *total* level of outstanding credit card debt. The Carter Administration in March 1980 called for a $4 billion reduction in this activity, which would bring the percentage growth in this area to around 28%, but this still will permit an increase of almost $139 billion.

It is clear that the problems of credit and their relationship to inflation are far more complex than the Fed admitted in its announcements. Not only does our tax policy encourage borrowing, but also around 190 different federal loan programs provide special incentives and encourage particular groups to borrow at rates considerably below the market. The Fed, like most regulatory agencies, is guilty of focusing on specific problems and ignoring broader issues.

Learning From Experience

There are many unanswered questions about the federal government's latest effort to control credit. It is premature to determine the program's near-term success or long-term consequences. The Board began unravelling the controls within two months of their establishment. In fact, it was likely from the outset that the job of credit allocation would not be pursued with much enthusiasm by the Board members. In a Buddha-like statement, Chairman Volcker was quoted on the day the program was promulgated as saying that the controls ". . . will remain in effect as long as needed and as short as possible."[16] Soon after the program was underway, there were complaints from Board members that they could not keep up with the growing regulatory actions and that the Board's lawyers were designing a complicated and in the long run potentially undesirable program.

Regardless of what happens with this particular program, significant questions remain. The almost dictatorial powers of the Credit Control Act of 1969 remain. The regulatory risks of credit controls and conflicting federal credit policies are issues that deserve careful public scrutiny. It is not too early to take steps to ensure that future policymakers and experts in consumer credit profit from this experience.

The regulatory problems faced by the Federal Reserve Board in implementing the consumer credit restraint program were considerable. The problems of conflicting policy goals and the regulatory risks inherent in credit regulation are certainly not unique to this program. It is not uncommon for the pressures of the moment to force

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government agencies to act before they have adequate information. The nature of this program probably justified waiving the normal time allowed the public to comment on a new rule. The lag time between proposal and final action probably would have resulted in perverse consumer borrowing activity. (The Consumer Federation of America did complain about the absence of a comment period and the Board told them that this was an exceptional case and by no means a precedent.) However, insofar as no public comment was allowed and no analysis provided, the Board should assume a special obligation to involve the public in evaluating the experience with controls. The unique complexities of consumer borrowing and saving deserve a careful economic analysis. Under normal circumstances the Board should have followed the guidelines on regulatory analysis in President Carter's Executive Order on Improving Government Regulations (E. O. 12044):

> Some of the regulations identified as significant may have major economic consequences for the general economy, for individual industries, geographic regions or levels of government. For these regulations agencies shall prepare a regulatory analysis. Such an analysis shall involve a careful examination of alternative approaches early in the decision-making process. . . . Each regulatory analysis shall contain a succinct statement of the problem; a description of the major alternative ways of dealing with the problem that were considered by the agency; an analysis of the economic consequence of each of these alternatives and a detailed explanation of the reasons for choosing one alternative over the others.[17]

The Depository Institutions Deregulation and Monetary Control Act of 1980, signed into law on March 31, 1980, contains a similar requirement:

> Sec. 803 Any regulation issued by the Federal financial regulatory agencies shall, to the maximum extent practicable, insure that—
>
> (1) The need for and purpose of such regulation is established clearly;
> (2) Meaningful alternatives to the promulgation of such regulation are considered before such regulation is issued;
> (3) Compliance costs, paperwork, and other burdens on the financial institutions, consumers and public, are minimized;
> (4) Conflicts, duplication, and inconsistencies between the regulations issued by the Federal financial regulatory agencies are to be avoided to the extent possible taking into account differences in statutory responsibilities, the classes of financial institutions' regulation and methods of implementation of statutory policy objectives;
> (5) Timely participation and comment by other federal agencies, appropriate State and local agencies, financial institutions, and consumers are available; and
> (6) Any regulation issued shall be as simple and clearly written as possible and understandable by those who are subject to such regulation.[18]

The Board should commit now to undertaking a regulatory analysis in keeping with the spirit of these requirements. The analysis should be made available for public review and comment. In addition, a symposium sponsored by the Fed to discuss the issues surfaced in the analysis would make a significant contribution not only to future credit control policies but also to a better understanding of the conflicts in federal credit policies. Both the Boston and Philadelphia Banks sponsored studies on credit issues in the 1970s. However, important new questions raised by the current experience deserve attention.

For example, were the increases in consumer loan activity contributing to inflation in March 1980 or not? If so, how much? What levels of growth in outstanding credit in an inflationary period are reasonable and when does it become unreasonable? Should we expect consumers to reduce their debt in an inflationary period? Obviously to do this willingly does not make economic sense to the consumer; so, is credit allocation or other general restraints the way to achieve this reduction? What responsibility does the federal government as a lender have in reducing the phenomenal growth in its lending activity? In addition, would changes in tax policy be a more effective way to reduce consumer indebtedness rather than raising the cost of loans?

What inequities occur when special protections for certain kinds of loans are granted? The risks that political rather than economic considerations will prevail are great. Is it proper for the Federal Reserve Board to administer such a program and what risks does it take in undermining its more traditional and detached role? The fact that some of these issues are outside of the Fed's jurisdiction should not eliminate them from an analysis of what approaches the federal government might take in the future.

> *. . . a symposium sponsored by the Fed to discuss the issues surfaced in the analysis would make a significant contribution not only to future credit control policies but also to a better understanding of the conflicts in federal credit policies.*

The Fed's independence and expertise would lend great weight to such an analysis. To be fully effective, however, this effort to examine the government's credit policies and practices would need the support of the House and Senate Banking Committees, the White House, the Treasury Department and the other financial regulatory agencies. This agreement to examine the issues should not be too difficult to obtain. The most important admission that the federal government could make in this important area is that we know so little about the problem. Pretending that the government knows what it is doing in this area could be a mistake of major long-term significance to the American economy.

Notes

1. "Anti-Inflation Plans Send Lawyers Leaping." *The Legal Times of Washington*, (Vol. II, No. 42) 24 March, 1980, p. 1.

2. Several components of the program were modified or lifted by mid-May 1980.

3. See Ira Kaminow and James M. O'Brien, eds., *Studies in Selective Credit Policies* (Philadelphia: Federal Reserve Bank of Philadelphia, 1975); *Credit Allocation Techniques and Monetary Policy* (Boston, Federal Reserve Bank of Boston, 1973) and Leland B. Yeager, *Proposals for Government Credit Allocation*, (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1977).

4. *Congressional Quarterly: Almanac. 91st Congress, First Session* (1969), Volume XXV, (Washington D.C.: Congressional Quarterly, 197) pp. 925–7.

5. Credit Control Act of 1969, 12 U.S.C. § 1901–9.

6. *Weekly Compilation of Presidential Documents*, Vol. 5 No. 52, December 29, 1969 (Washington, D.C.: U.S. Government Printing Office, 1969) p. 1785.

7. *Weekly Compilation of Presidential Documents*, Vol. 16, No. 11 March 19, 1980. (Washington D.C.: U.S. Government Printing Office, 1980) pp. 476–482.

8. Op. cit. *The Legal Times of Washington*.

9. Federal Reserve Press Release, March 28, 1980. "Consumer Credit, Q and A."

10. "Squeeze on Bank Credit Cards May Benefit Big Retailers, Who Can Issue their Own." *The Wall Street Journal*, 17 April 1980, p. 3.

11. See note 7.

12. John G. Heimann, "The Realities of the Market Place," *Journal of Retail Banking*, Vol. 1, No. 3, December 1979, pp. 1–4.

13. Federal Reserve Press Release, March 14, 1980, Final Rule: Consumer Credit. (Title 12—Banks and Banking: Chapter II—Federal Reserve System, Subchapter A—Board of Governors of the Federal Reserve System, Docket No. 4–0280, Part 229—Credit Restraint (Subpart A) p. 5.

14. *Federal Reserve Bulletin*, Vol. 66, No. 3, March 1980 (Washington, D.C.: Board of Governors of the Federal Reserve System), A–42.

15. *Special Analyses, Budget of the United States Government*, (Washington, D.C.: U.S. Government Printing Office, 1980), pp. 141–206.

16. Quoted in *The New York Times*, March 15, 1980, p. 32.

17. 43 Fed Reg 12661, March 24, 1978.

18. P.L. 96–221, 12 USC 3522.

19. The Office of Management and Budget has proposed legislation that would take some important initial steps toward establishing a credit budget.

Chairman **Annunzio**. Thank you very much for your statement. I am going to recognize Mr. Hansen for 10 minutes to ask questions.

Mr. **Hansen**. Thank you, Mr. Chairman.

Mr. Genetski, earlier this week the U.S. League of Savings and Loan Associations told this subcommittee that judicious use of credit controls could have prevented the problem that thrift institutions face today and could have precluded the need for the regulators bill, and the capital assistance legislation passed by the House.

Is this at all possible, and could such controls have helped the thrift industry?

Mr. **Genetski**. In my testimony I tried to get at exactly the opposite point. Interest rate ceilings aggravated the problem that the thrift institutions find themselves in today. Those sorts of controls usually end up leading to that particular type of problem.

Mr. **Hansen**. So you come down exactly the opposite from that statement, is that correct?

Mr. **Genetski**. That is correct.

Mr. **Hansen**. Does anyone else in the group have any comments regarding that particular question?

Some argue that, and I will direct this to whoever, since there is a group of you, and I will leave it to you, whoever feels a sense of urgency to comment on it, some agree that the implementation of the Credit Control Act in 1980 brought down interest rates.

Is it not more likely that the temporary interest rate declining in that year was what accounted for the decline in economic activity which had already started before the imposition of the credit controls?

Mr. **Genetski**. The decline in economic activity at that point was primarily the result of restrictive monetary policies that have preceded the experience in the spring of 1980. As the economy collapsed at a very rapid rate, the interest rates came down. Credit controls may have exacerbated both the decline in the economy and the decline in interest rates at that time. Indirectly, the answer to the question would be, perhaps, that controls did in fact help bring the rates down more rapidly than they otherwise would have. The controls also exacerbated the decline in economic activity.

Mr. **Hansen**. You are saying perhaps we are throwing the baby out with the bath water.

Mr. **Meiselman**. I would like to comment on that.

I would like to observe that only some interest rates came down because there were many people who were not able to borrow directly and I think you have to ask yourself what was the rate of interest to a typical consumer who uses consumer credit, say, somebody building a family between the ages of 25 to 45, what was the cost to that family of acquiring credit at that time.

The point of the control was to increase interest rates or the cost of credit to that particular family.

The notion was to drive the funds out of that use to some other use, and I think it is not accurate to look only at the rate on Treasury bills as an indication of what happens to interest rates during controls, and so that it is not clear to me that properly weighed that interest rates really went down at that time.

Some interest rates went down and some went up to astronomic levels.

Mr. **Hansen**. For any witness, under any circumstances, could credit controls bring down unemployment, inflation and interest rates?

In other words, what sacrifices must we make to achieve the interest rate reduction assumed in H.R. 6124? Anyone?

Mr. **Meiselman**. I don't believe there would be sacrifices to be sure, but the sacrifices wouldn't give us lower interest rates. They would be pain for the sake of pain, and in the process there would be some people who on the side would be better off.

The pains would not be worth it because the vast bulk of the country and the vast bulk of our citizens would be much worse off.

It is not the notion that somehow the pain itself will give us good returns. I think that masochism is not the answer here as it is any place else.

Mr. **Hansen**. Would it be fair to say that under credit controls large business units, especially those with well-established international connections, have more alternatives available for financing their needs than do smaller businesses and households?

Mr. **Mooney**. Yes, and I add, this is probably equally true when you are talking about higher income, wealthier individuals. They have more credit alternatives. To the extent credit controls could at all be effective, the large businesses that can enter international markets and have many sources of credit available and wealthier individuals who are actively sought after by credit issuers would not have the problem.

To the extent the problem existed, it would mainly affect the less financed smaller businesses and lower income individuals.

Mr. **Hansen**. One of the problems with international operations is that they have the benefit of operating under sets of rules that domestic operations do not have the prerogatives of using.

Banks that can branch into the Cayman Islands—and I have even found the Federal Reserve on occasions encourages branching out so they can compete—what does that do to the local establishment that does not have the two-way system to operate?

Mr. **Mooney**. It provides an advantage to anyone that has greater access to credit, particularly in this instance, credit outside the United States where it is much more difficult or impossible to control.

Mr. **Hansen**. This always disturbs me. In making laws in Congress, we always point our fingers at some of the bigs. We are going to control some of the excesses of General Motors or the big banks, but usually they are large enough, Sears and Roebuck tying up the Federal regulators in the courts for years and years; they can do it and they can pass the costs on to their consumers or customers immediately and it is the little guy that can't compete with the power of the Federal Government.

He gets stuck with problems and costs that he cannot pass on. Do you have any feelings in that regard as it applies to credit controls?

Mr. **Genetski**. I want to agree. Your observation is correct, and that is exactly what happens and that is one of the reasons that I personally would be opposed to controls.

Mr. **Hansen**. Is it possible to administer credit controls on a limited basis, or do controls of this kind have a built-in tendency to spread and become more and more comprehensive?

Ms. **Spillman**. It is like being a little bit pregnant. In other words, if you have them in one spot, people in the next sector are going to say, well, the next one is us.

If you have the ability, they will extend it to other sectors, so there is no just controlling one sector and those sectors that have the control, the money, will move to another sector.

Mr. **Hansen**. Is my time up?

Chairman **Annunzio**. Go ahead.

Mr. **Hansen**. If this bill is enacted and a credit control program is established, is there any way to restrict credit for corporate mergers without interfering with those corporate divestitures such as International Harverter which may preserve jobs?

Mr. **Genetski**. I don't believe there would be a good way, but I don't like the premise that all corporate mergers are necessarily inefficient. What we have to understand is that in a market economy those people deciding whether or not to engage in a corporate merger are the people who are going to most directly be affected by the success or failure of that merger and they are going to be rewarded or penalized and study it much more closely than some sort of unaffected regulatory body which might otherwise make that decision.

Mr. **Hansen**. Mr. Chairman, I have a number of questions that I would like permission to submit properly allocated, I suppose, to the witnesses which I would like to have included in the record, if that would be permissible.

Chairman **Annunzio**. I want to assure the gentleman from Idaho that the record will be kept open. You can submit your questions to each witness.

I will ask each witness to respond to the question and mail them back to the subcommittee.

Mr. **Hansen**. Mr. Chairman, I appreciate this and normally it is procedure, but I wanted to be sure that that was understood with the witnesses and I would also like to advise the witnesses that since I am not a regular sitting member of the subcommittee, that the chairman had full prerogative as to whether I should participate or not this morning, and I want it known publicly that for my part at least and I am sure on the part of the minority, we appreciate the indulgence of the chairman in allowing the minority to particpate in this way and, Mr. Chairman, I think my 10 minutes are up, so I will return the time to you.

Chairman **Annunzio**. I deeply appreciate my friend from Idaho participating in the meeting this morning, and in fact it was lonely.

I was happy to have you here on the panel.

Professor, I listened to your statement and I marked underneath, I would like more clarification of what you mean where you say here on page 3, Professor Meiselman, I will read it:

Congress and the Federal Reserve Board, the creature of Congress—now, you are intimating there that the Federal Reserve Board is a creature of the Congress of the United States. All the years I have served on this committee, I am not the best friend that the Fed has, so I want you to know that.

I am trying to get more clarification.

Explain to me, if you can, how the Fed is responsible to the Congress of the United States. That is a great independent body that we have.

Mr. MEISELMAN. According to the Constitution, the Congress has the power to coin money and regulate the value thereof and it is under that power that the Congress created the Federal Reserve.

The Federal Reserve is independent of the executive branch of the Government; that is what is meant by the independence of the Federal Reserve.

The Federal Reserve does not report to the President. It does not report to the Secretary of the Treasury.

The Federal Reserve reports to Congress and, in the House of Representatives, to this subcommittee.

Chairman ANNUNZIO. I would like you to tell me how they report.

Mr. MEISELMAN. They send in an annual report which for most of the years of the Federal Reserve, nobody read. In more recent years there is a reporting procedure where, twice a year, once in January or February here and then next week on the Senate side, the Chairman of the Federal Reserve reports to the Banking Committee.

Now, if the Congress does not exercise its prerogative in requiring the Federal Reserve to pursue appropriate policies, then the fault rests with the Congress.

The Federal Reserve is not independent of the Government. It is not independent of the law. The Federal Reserve is not independent of the Congress.

Now, if your colleagues don't act on that basis, then who is to blame?

Chairman ANNUNZIO. You say the Fed is responsible. What about the President, the executive branch?

Mr. MEISELMAN. Under the law, the President is not responsible for monetary policy. To be sure, he will talk to the Federal Reserve. He may make his wishes known, but a close reading of the law means that the Federal Reserve does not have to follow it, and if the Federal Reserve does things that the President does not like, the President cannot remove them.

Chairman ANNUNZIO. He cannot?

Mr. MEISELMAN. Of course, he cannot. They have 14-year terms.

Chairman ANNUNZIO. Do you favor legislation that I have favored for a long time, making the Chairman of the Fed coterminus with the President, his Presidential term?

Mr. MEISELMAN. I speak only for myself, not the Chamber of Commerce on this, and I personally think that would be a step in the right direction. It is a very small step but I am grateful for anything.

The country as a whole holds the President responsible for the consequences of Federal Reserve action.

The presumption is, the underlying thread is that the Federal Reserve is somehow like the judiciary and that we have a body of law, and that we have to protect the judges in carrying out the law or interpreting the law, so we make the judges, we make the judiciary independent, but they have a body of law, and there is a review procedure. There is an appeal procedure that goes all the way up to the Supreme Court.

You have given them power, but you have never really told them how to use it.

Chairman ANNUNZIO. How about the auditing of the Fed? I have advocated that for a long time. How do you feel about auditing the Fed?

Mr. MEISELMAN. What purpose would that achieve? I don't have strong feeling about it one way or another.

Chairman ANNUNZIO. Well, any time, if you have the GAO audit the Fed, they are taking in hundreds of thousands of dollars, and believe me when I tell you, they live like the Rajahs, you know, some of the sheiks, where they spend their money on parties and entertainment, bourbon, and I am not against it.

I think we ought to know. I know I file a disclosure statement.

Mr. MEISELMAN. Including the bourbon?

Chairman ANNUNZIO. Including the bourbon.

Mr. MEISELMAN. I know that there are some members of this subcommittee who have had strong feelings about that. I recall that from a time that I was a staff member of the Banking Committee, and I worked for the late Mr. Patman.

There is usually something to that. The people of the Federal Reserve feel strongly that this would constrain their independence and to my mind that is not necessarily good or bad.

It depends on the content of the constraint. We may order them to do something that is not in the public interest, so the constraint itself is not necessarily good, so I think, if you want to talk about having the Congress change the constraints on the Federal Reserve, then we ought to be specific about the constraints, because directing them to do something that is bad may be better than no directive at all.

I am sure you are acquainted with the fact that if it weren't for Mr. Patman, that it was this committee that established the reporting features to the Congress, but prior to that time they didn't even report to the Congress.

There was a slim volume that went to the Speaker of the House.

Chairman ANNUNZIO. I have always fought this independency business. I think people should be responsible and belong. If they want to be independent, that is their business, but they must become part of the political process, and the political process is a two-party system in this country, and that is what made it great, so this independency can be carried out too far.

Mr. MEISELMAN. Mr. Chairman, if I may, I have written various studies proposing rules that Congress might adopt which would seem to me would improve the performance of monetary policy and, if I may, I would like to submit my most recent study for the record.

Chairman ANNUNZIO. Without objection, it will be part of the record.

[The study submitted by Mr. Meiselman is retained in the subcommittee files.]

Mr. **Prins**. Professor, you have raised some very interesting points that I would like to follow up on.

The problem that we faced for the 20 years that I have been up here, and I worked for Mr. Patman for 10 years, and you and he must have had some very interesting conversations with your views and knowing Mr. Patman's views on the Fed.

Mr. **Meiselman**. Oh, yes.

Mr. **Prins**. My question is this: The Federal Reserve is a creature of Congress, as you say, but we can't seem to control them because they don't pay any attention to what the Congress says.

We pass sense of Congress resolutions. We pass laws, we pass resolutions.

We make reports and the Federal Reserve comes before this committee and they say, well, we have listened to what you say, but we don't agree with it. When we pass a law, the Federal Reserve, time after time, has said, we don't think it is a good law and because we don't agree with the law, we are not going to pay any attention to it.

Now, my question to you is, Mr. Annunzio can't sue the Federal Reserve.

Mr. Reuss sued the Federal Reserve, and the courts held he did not have any standing to sue them. There have been a couple other Members of Congress who have sued the Federal Reserve, and the courts have denied standing.

What do we do when the Federal Reserve thumbs its nose at the Congress?

Mr. **Meiselman**. If you pass a resolution that does not mandate specific behavior——

Mr. **Prins**. We have passed laws, sir, and they pay no attention to it.

What does Mr. Annunzio, as a Member of Congress, do to get the Federal Reserve to respond to Congress?

Mr. **Meiselman**. I am not a lawyer, constitutional lawyer, and if in fact the Federal Reserve is not obeying the law, then I would presume there ought to be appropriate sanctions, including impeachment, but I don't know of the specific instance that you have in mind.

It is beyond my professional competence to tell you what recourse you have.

There are impeachment proceedings and that would require the cooperation of the other Members of the House.

Chairman **Annunzio**. The Federal Reserve is a central bank here in the United States. How many other countries have central banks?

Mr. **Meiselman**. Virtually every country has a central bank.

Chairman **Annunzio**. An independent central bank?

Mr. **Meiselman**. Typically not.

Chairman **Annunzio**. They are all under their parliaments.

Mr. **Meiselman**. It does not mean they perform any better.

Chairman **Annunzio**. I don't mean performance.

We are the only country that proclaims this great independency. How did this country get along before?

Mr. **Meiselman**. Quite well.

Chairman **Annunzio**. Well, I thank you.

Mr. **Prins**. Mr. Chairman?

Chairman **Annunzio**. I will try to follow your advice, if I can get more than 10 votes, I will be lucky.

Mr. **Meiselman**. Maybe you put your finger on the source of the problem.

Chairman **Annunzio**. They are dangerous to this country, and people better wake up.

Mr. **Prins**. Could I follow up on one additional question on the Fed to the other members of the panel, particularly those who are, well, I guess everybody except Mr. Meiselman would fit into this because they dealt with this thing directly.

When credit controls were implemented back in 1980, you were not too thrilled with the implementation of credit controls per se, but in talking to many of you directly and to your industries, the thing that really got you was not the law, but the cockamamy regulations, that the Federal Reserve Board came out with, and isn't it true that the biggest problem you had was not complying with the credit control law, but the credit control regulations, where you were spending most of your time filing forms and running computers on the percentage of your increase?

I know I am not going to get you to say that credit controls are all right, but wouldn't credit control have been a little more palatable if we hadn't those horrendous regulations?

Mr. **Genetski**. I would say the answer is no, from the perspective of the banking industry. Trying to regulate the general aspects of the credit allocation program by its very nature, the complexity of the system could give rise to that sort of confusing, conflicting regulations.

I believe the Federal Reserve Board tried in good conscience to do as good a job as could conceivably be done and I believe it was given an impossible job.

Mr. **Prins**. I see some folks in this room who, when credit controls were allocated, came running into my office from your organization pleading with us to do something to the Federal Reserve to change those horrendous regulations, and now you are telling me they were no problem.

Mr. **Genetski**. I said they were a tremendous problem. I am trying to concentrate on the source of the problem; that is, by the nature of credit controls, I believe you are always going to have those sorts of problems pop up.

Mr. **Prins**. Let me end with this and to change the thing.

If Congress passed a law that said when credit controls are put into effect, that the amount of credit that you have outstanding on the day the law goes into effect, you cannot increase that credit by more than 5 or 10 percent on a yearly basis as long as the controls are in effect, and we are not going to come in and audit you or examine you.

We are going to depend on your doing it, but if you do not do it, there will be penalties.

I am not asking you to comment on whether that is good or bad, but isn't that a lot simpler than what the Federal Reserve did?

Mr. Mooney?

Mr. Mooney. Answering for the general merchandising retailing industry, that may sound simpler, yes, but the problem is, and the problem was for us at the time, when the credit controls were invoked in March, this is at a period of time when our industry is not at a very high level of financing.

The receivables, inventory levels, are much lower than is normal, and so if somebody were to come and say, which sounds very simple, you can't increase the amount of credit or the amount of your receivables by 5 or 10 percent, that might sound very simple to comply with, but it would kill our business because it happened that the credit controls were enacted or invoked at a period of time when our normal credit was at a low level, so I would agree with Mr. Genetski that the—it may sound initially very simple.

When you try and enforce them in our complex economy, they turn out to be not quite so simple.

Mr. Prins. Were the Federal Reserve Board regulations simple?

Mr. Mooney. Absolutely not.

Mr. Prins. This issue, it was members of your organization that came to me with the idea, so I am a little bit astounded now to hear that you all don't think that is a very good idea.

Mr. Genetski. Can I mention another complication such as the retailers ran into, and that was the case with respect to commitments that banks had made at the time, legal commitments to honor credit requests, and again, if the law is straightforward and simple and says you can allow your credit to expand by 5 percent, you have a question as to which sort of legal regulation you are going to comply with, the law or the one that you have made with your customer.

It is a complicating aspect. It suggests that the system is more complicated and not amenable to those sorts of things.

Mr. Prins. Maybe there is such an abhorrence of credit controls that I can't get an answer in any way, but what I am trying to get across is, is there an easier way?

If we have to have credit controls, is there an easier way to do it than what the Federal Reserve did last time?

Mr. Genetski. I don't believe that there is an efficient way at all to have credit controls.

Mr. Prins. Well, I am saying that if we have to have credit controls.

Mr. Mooney. The answer is probably yes, but I think that it would require looking at the situation, I don't think there is any one rule that could very simply be applied to different industries in our economy.

I think the only thing that could be done that might make a system like this more workable would be to try and get an understanding of what makes the mortgage market tick and to get some input from the industries that are involved so you could come up with some rules that could be complied with in a reasonable way.

Mr. Genetski. Honestly, any system could be improved upon. The problem with credit controls and perhaps the best way of looking at it is the Soviet Union has had a type of credit control system in effect for as long as they have been in power and I am sure they have tried their darnest to protect it.

The end results are disastrous.

Mr. **Prins**. Japan has had them, too, and they have done a pretty good job.

You said that credit controls, you were citing or giving the views of a Member of Congress, that credit controls might require people to pay cash when they go to a doctor, and I wonder, maybe your section of the country is different, and if it is, I might want to move there, but I don't know a lot of doctors that will let you in.

The first thing they examine is not you, they examine their wallet and if you have the cash, you will get in to see the doctor.

Is that different?

Ms. **Spillman**. It depends upon the doctor that you go to. By and large, doctors will indicate, if you either want to know, when you call, they will say the fee is such-and-such and payment is accepted.

However, doctors are accepting credit cards today, and you can charge, in effect, your bill at the doctor, and indeed, if it goes beyond a month, you will pay interest on it.

Mr. **Prins**. The point I was getting at is we don't have credit controls now. I don't know more than a handful of doctors who want anything but cash or a credit card up front.

Chairman **Annunzio**. You make an appointment with a doctor, this is my experience, he does not want to see you as the patient until you have been interviewed by the nurse and you fill out a long form about your grandmother and your mother and father, what kind of insurance do you carry and after all this important statistical data, if you are not dead by then, he will be good enough to examine your pulse.

At least, that has been my experience.

Mr. Durkin, I am going to ask only a few questions.

I have many questions, but I am going to write to each one of you and you will please answer these questions for the record.

You argue that credit is fungible, and therefore, difficult to control, since the consumer could pay cash for one item and credit for another and it would be impossible to determine whether credit was actually used for one purpose or the other.

Can you tell me how many consumers could afford to purchase a home for cash?

Mr. **Durkin**. Well, I wouldn't know right offhand how many can afford to purchase a home for cash. It obviously isn't very great, although a large number of homeowners have owned homes before and have substantial equity and when they sell those homes, they can purchase homes for cash.

Many older people in particular are able to do that and they do that very frequently. I wouldn't know how often that would happen in the scheme of things.

Younger people would be less likely to be able to do that than older ones.

Chairman **Annunzio**. You will agree that in today's high interest rate market that the young people of this country will never own a home?

Mr. **Durkin**. It is difficult these days to get started, that is correct.

Chairman **Annunzio**. Mr. Genetski, you denounce credit control as a quick-fix solution for restoring economic health.

The economy has gone into cardiac arrest. Isn't it better that we give the economy a shot of adrenaline through credit controls rather than wait for the Fed's ambulance on monetary policy to drive the patient to the hospital, or the economy will be dead on arrival?

Mr. GENETSKI. No one would deny that the economy is in terrible shape today. The issue here is whether or not——

Chairman ANNUNZIO. I want to tell you, Mr. Genetski.

When I got to these hearings, our field hearings of our committee, we went around the country—the thing that demoralized me to no end is when these old people testified before the committee and they told their stories of the several suicides by older people who could not meet their bills that were living on fixed incomes.

This is how bad things are out there.

I have them in my own district that I represent.

The city of Chicago, I represent the most affluent section of Chicago. Prior to the inflation when homes were built in those days, it cost anywhere from $75,000 to $250,000, so that some of those homes are in the million-dollar bracket in my district, and believe it or not, they vote for me, a Democrat, for Congress, so not all millionaires are Republicans, you see.

Mr. GENETSKI. There were some very serious economic problems that plagued our economy in 1932, as well, and the Congress at that time took some very dramatic action, and the action made the situation worse, not better.

I think that is the question that we are trying to concentrate on. Is action just for the sake of action likely to improve the situation or could it throw a recession into an economic depression?

I have no doubt if we make all the wrong economic moves, that is going to be the end result. We have to look very carefully about the moves that are made. We have to look even more carefully at an economy that is in the shape it is in now than we do at an economy that is prospering.

Chairman ANNUNZIO. I understand, but how much longer can we wait before more disasters?

The automobile industry is gone. The building trades are gone, and this is what is happening.

I could go on and on and on. They are gone. They are dead, because somebody is waiting to supply somebody with another side of the paper, you know, supply side.

When you make a mistake, you admit it. When the course isn't working, you change the course, and this is what is wrong today.

Congress, the President, nobody wants to change the course, and we have established a great coalition here in the Congress, so that the course won't change.

In the meantime, inflation, the interest rates go higher. The unemployment is higher. The steel industry has announced now they are closing the Youngstown Sheet & Tube in Chicago.

In Peoria, the Harvester Corp., in Peoria, Ill., and all through. Do you know in your own city where Harris Trust is 1 mile from there, unemployment is 50 percent. Fifty percent of those black people 1 mile from Harris Bank are unemployed.

What are we going to do about it?

Somebody has to try something, and if it does not work, say it does not work. I am not talking politics here. I am talking about America, about people.

I am not going to ask any more questions. I have a series of questions but if somebody wants to respond to any of my remarks, I will mail to you the questions that I have for you, and I would appreciate your answering them, and I want to tell you how much I appreciate, although we don't agree on the credit control bill, but I do appreciate your appearance this morning and I do appreciate your testimony.

I know I am the type of person that likes to hear another point of view. I really don't have a closed mind. Some people think I do have a closed mind, but if you accuse me of having a closed mind on the Federal Reserve Board, yes, I do.

I have watched them for 18 years, and I tell you, they have done irreparable harm to this country and to the banking system. And under that deregulation bill that we passed, the power that we have given some of these people, they are now in the process, the regulators, anybody who watches the regulators, they are now in the process of chewing each other up, and that is the reason that you have defaults like Penn Square Bank in Oklahoma City and others. We had the witnesses yesterday, the Comptroller didn't know what the hell the FDIC was doing and they didn't know what in the hell the Comptroller was doing and they were trying to place blame each other.

It is all right to place blame, but if you are one of the people that is going to lose your money and pay for the fall of these institutions, because while I am talking to you today, believe you me, I am not saying this, the Chairman of the FDIC said, there are 268 more problem banks in the United States, so momentarily another one can drop, and I thank you very, very much for your appearance this morning.

The subcommittee will stand adjourned until Tuesday.

[Whereupon, at 11:50 a.m., the subcommittee was adjourned, to reconvene Tuesday, July 20, 1982.]

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